Inquiry into Liquidators and Administrators
Senate Standing Committee on Economics

Dr Richard Grant
Principal Research Officer
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Email: richard.grant@aph.gov.au

19 March 2010

Dear Dr Grant

Thank you for your request to make a submission and for the extension of time to facilitate this. The following is submitted in relation to the concerns apparently raised around insolvency professionals, fees and practice.

Yours sincerely

Dr Colin Anderson

Law School

Queensland University of Technology

Dr David Morrison

TC Beirne School of Law

The University of Queensland

INTRODUCTION

1. The terms of reference for this inquiry are to: "*investigate the role of liquidators and administrators, their fees and their practices, and the involvement and activities of the Australian Securities and Investments Commission, prior to and following the collapse of a business*".
2. Every profession will at times have to defend itself when a member or members misbehave and the case of *Ariff* is timely in that sense. It is not surprising given current economic conditions and the *Ariff* case that an inquiry has been initiated.
3. How well the insolvency profession is coping right now does not appear to be an issue at least on the surface. If the success of a profession is dependent on how well it maintains the confidence of its clients and the public however, then perhaps the senate inquiry suggests some confidence in the profession has been lost in recent times.
4. What seems unclear is whether that is a prescient view that will reveal a widespread problem with the profession of growing proportion, whether the view is based on data that the Australian Securities and Investments Commission (ASIC) holds (but has not released) about the profession, or whether it is a knee-jerk reaction to the unfortunate and particular case of Mr Ariff and a few others that taints the profession as a whole. If the latter then, it is respectfully submitted that an inquiry is overkill.

SCOPE OF INQUIRY

5. In looking at what submissions may be appropriate the terms of the inquiry are quite wide and suggest a broad review of the place of liquidators and administrators. The insolvency practitioner is at the core of the insolvency procedures under the Australian regulatory system. Hence a review of their role is a large undertaking indeed. It is not possible to review all aspects of the role of the insolvency practitioner given the detailed legislation and the myriad of professional and commercial constraints upon their service.
6. We will make two very general points initially (we suggest that each goes to the heart of the matters here) and then proceed to examine a number of specific proposals for change. The specific proposals will be confined to matters going to the registration, supervision and remuneration of liquidators and administrators. We have not delved into specific proposals for reform of particular types of insolvency procedures. We believe that these broader developments require more detailed coverage and consideration of a wide range of issues not just the specific consideration of the role of the insolvency practitioner.
7. At the outset we argue that there is one matter that needs serious consideration by the government in the process of law reform in this area above all else. This is there is (in the words of the Parliamentary Joint Committee on Corporations and Financial Services Report (2004) a "*paucity of contemporary systematic comparative information and*

empirical data on the operation of corporate insolvency laws"[1] . Australia is very poorly served in terms of the publishing of available information that contributes to informed debate and ultimately informed decision making. We are in desperate need of reliable and independent data about the costs and benefits of our processes and the practice of the profession.

8. The matters upon which there is a lack of adequate data and hence proper information upon which to consider reform goes well beyond what seem to the immediate matters of concern in this inquiry. We argue specifically below in the context of the matters raised here. However that this is part of a broader issue that hampers proper policy development in this important area of the economy.[2]

9. The general lack of data on insolvency generally in Australia and corporate insolvency in particular is displayed here by the lack of information about how many 'Ariff' type problems exist under our current system. Fundamental then is determining whether there is in fact a 'problem' with the operation of our current procedures. It is possible to argue that the level of wrongdoing by insolvency practitioners is small relative to the matters that they deal with. This is no doubt the basis of some submissions to the enquiry. On the other hand it could be widespread, necessitating changes to the law and practice. The bottom line is that we simply do not know. If there is one positive outcome above all others that the inquiry could promote to improve the quality of our insolvency system, it would be to recommend the independent collection of data associated with business failure and the operation of our insolvency regimes.

10. It is strongly argued that there is scope within Australia for a body to be established along the lines of the Australian Institute of Criminology that independently gathers, analyses and researches data relating to corporate law and corporate operations (including insolvency). ASIC currently collects a lot of data from corporations that it administers but little is ever utilised except in a supervisory sense. This is not surprising given the competing demands upon ASIC's resources and the lack of any incentive to provide researchers with the access they require to undertake meaningful independent research. The focus upon insolvency here suggests that at least in that area there is a vital need to know more about what is going on. It cannot be regarded as satisfactory to proceed with policy changes without having some data upon the extent of the problems said to exist.

---

[1] Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a stocktake* (2004, Commonwealth of Australia) at [12.64]

[2] The important economic role of insolvency legislation has been broadly recognised indiscussion papers such as the World Bank see *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* 2001 available at http://siteresources.worldbank.org/GILD/Resources/FINAL-ICRPrinciples-March2009.pdf and in the Australian context see the discussion in Bickerdyke, Lattimore and Madge, *Business failure and Change An Australian Perspective* available at http://www.pc.gov.au/research/staffresearch/bfacaap/bfacaap.pdf

ASIC is burdened with a multiplicity of roles and the devotion of scarce funds to providing better statistics about its insolvency operations is understandably a low priority when compared against matters it gets more political pressure around, such as directors' duties for example.

11. ASIC has a further problem in this area being the regulator of the insolvency profession. Any data produced may be used to criticise the work it is doing. This is not to suggest that ASIC is inadequately performing its task currently, only that it has little incentive to spend scarce resources on it. We would repeat again a recommendation made in 2004 by the Parliamentary Joint Committee on Corporations and Financial Services Report where Recommendation 58 was that *The Committee recommends that the Government support a program of research into the impact of insolvency procedures, if necessary, by providing a specific allocation for the conduct of such research by ASIC, the professional associations and/or commissioned researchers.*

12. To the best of our knowledge this has not yet been followed. Consequently we are as much in the dark now about performance in the insolvency industry as we were in 2004. Currently there are academics such as ourselves and other colleagues at various institutions around Australia who are willing to engage in research in areas relevant to the enquiry but it is almost impossible to obtain the appropriate data because it is simply too expensive to purchase it from ASIC and possibly for financial reasons ASIC is unable to provide it without payment. Whilst research funding is available to a certain extent it will not cover the purchase of data. If we take one area relevant to this enquiry – the professional remuneration and fees charged by insolvency practitioners. We have no comprehensive data upon that. There is no comprehensive data enabling any meaningful comparisons or conclusions to be drawn. We would contrast this with the position in the United States where funding by the profession itself has enabled comprehensive data to be collected[3] in this area. If such data were able to be collected in Australia some international comparisons might be possible to see if charges here are higher than in comparable countries. Because of our system it is not possible to obtain this data outside of the government agencies of ASIC and ITSA.

13. Our system of regulation needs to be reviewed on an ongoing basis. This is best achieved by having a system in place that enables the appropriate data available for those who wish to undertake research. It would be unfortunate if information is gathered for say this review but in five or perhaps 10 years time it is necessary to review matters again and no empirical research has been undertaken.

14. A second general point is that insolvency invariably represents a very public failure on the part of at least some of the parties involved in the business. There is also a continuum of public interest in the failure depending usually on the status of the company concerned

[3] See for example Lubben S., *American Bankruptcy Institute Chapter 11 Professional Fee Study* available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1020477##

(public or private) and the level of investor dissatisfaction, the latter often related closely to perceived political costs. Further, it is quite fundamental that some parties are going to lose out as that is what insolvency means.

15. This realisation of failure and loss leads to behavioural activity such as blame-shifting between the parties as well as the seeming inevitable scrambling for available assets by the various stakeholders. Whilst insolvency laws seek to place a fence around the assets of the company so as to limit the inequity arising from those first to take legal action, it does not relieve the ferocity of the fight over the remains of the business and the resentment that arises against the insolvency professionals, who most persons suffering the loss will consider to be an unnecessary expense and in some instances, the cause of the ultimate failure of the business. Another important aspect of this dissatisfaction is that parties do not understand the legal obligations of the liquidator and blame them for performing tasks that they are required to perform by law. Whilst the profession itself and the regulators have some obligation with respect to explaining what the processes involve, there are often individuals who complain loudly but do not listen to these explanations.

16. Although there may be the occasional successful rescue, most cases will involve significant losses and it is therefore not surprising that the stakeholders are dissatisfied. Indeed it is unlikely that stakeholders will be happy whatever the outcome in these circumstances. This leads back to the point above about finding comprehensive data about the process- it is unlikely if we ask stakeholders if they are happy with the manner in which their losses were borne we will get a positive response. Therefore the issue needs to be dealt with in a more rigorous way and more objective information used to inform policy.

17. The professional tasks (such as finding assets, sorting of claims, determining priority matters) do not occur without cost and the cost must be borne in some way. Society will benefit from an effective insolvency system. The benefits are well argued and indeed well recognised in the literature.[4] The issue that needs to be decided upon is how are the costs controlled and who bears these costs. It is likely that no one wants to pay them or at least bear them, even proportionately. In Australia (as with similar jurisdictions such as the UK) the costs are almost entirely borne by the participants most directly by the creditors. Apart from the minor role played by the "assetless" administration fund, the creditors pay for the work of the insolvency practitioner. Where priorities apply it is the creditor with the lowest priority who will bear this cost. It is possible to adopt other methods of dealing with the costs involved. We might appoint a public authority to conduct the winding up. This is a possibility with respect to personal insolvency. Also a more direct role for courts might be contemplated by adopting the system in the United States where

[4] See for example Warren E., 'Bankruptcy Policy' (1987) 54 *University of Chicago Law Review* 775 –particularly at 793 in respect of costs. See also Jackson T *The Logic and Limits of Bankruptcy Law* (1986)

a specific Bankruptcy Court operates with a more hands on involvement. These options shift the cost more onto the general revenue.

18. This inquiry whilst wide in scope may not wish to address the fundamentals of the system we have in place in this manner. To shift costs to the public purse more generally would require a re-think on the structure of our system and that seems not to be an issue that the Committee wishes to address.
19. In conclusion we emphasise that much more data needs to be made available to inform debate and policy in this area. We strongly argue for some formal steps to be taken in this regard to ensure support for a program of research into the impact of insolvency procedures and related matters. By making more data available it enables ongoing research likely to highlight any problems that may develop in the system as it develops. Our second point is that the nature of the insolvency itself creates an atmosphere of dissatisfaction and complaint. This is particularly going to be the case where the stakeholders effectively bear the cost of dealing with matters collectively. Accordingly there is a need to ensure that this dissatisfaction is evaluated in an objective and informed way.

RECOMMENDATIONS

20. It is our view that recommendations for regulatory improvement (often misnamed reform) are only usefully provided when the varying motivations are backed by data that shows the motivation and necessarily by analysis provides the most likely way forward in terms of need for change.
21. Given the absence of data in the instant case, it is worth considering the means by which we have the current system of dealing with insolvent debtors. The system currently in place is one that has developed slowly over time by change directed at improvement. The Australian system is one where the insolvency practitioner is expected to play an independent role and the court and other regulatory authorities act as supervisors only.
22. The developmental status of the current insolvency system means that there is always a danger of a rogue practitioner acting in an improper manner. It seems unlikely that we might move towards a situation where the courts might take a more hands on approach to insolvency administrations here.
23. Individual insolvency practitioners are placed in the position of being fiduciaries because they deal with the funds of others and because they have control over their own fees and expenses to a large extent (because they can control the procedure upon which their fees are based). There is therefore a degree of conflict inherent in their role. The 2007 amendments to the Corporations Act sought to give creditors more control over this and probably needs more time to be tested.

24. It is not unreasonable to posit that even if the Australian courts were to take over the administration of insolvent companies, there is still a strong possibility that at some stage an insolvency practitioner will not live up practically to the ideal standards set and expected.

25. In any event, a fundamental change to the administration of the system almost certainly requires the establishment of a specialist court requiring a significant investment of public monies that is difficult to justify based on the anecdotal evidence to hand.

26. Therefore it is posited that the performance of those within the existing institutional framework to look for better performance of their respective roles. However because ASIC is not directly involved it is only ever going to be possible for it (or any other regulatory agency) to act in a reactive manner with respect to misbehaviour.

27. A possible area of improvement if fundamental change is not on the agenda is to look at the process of reporting complaints and how those complaints are dealt with. This will require a financial commitment at least in terms of increased personnel to gather and report the information. If such a process can be streamlined and improved it will benefit all participants and ultimately stakeholders.

28. Australia is recognised as having a strict regime of registration when it comes to insolvency practitioners. The registration regime has been analysed by Associate Professors David Brown and Chris Symes[5] in the context of what is used in both the UK and New Zealand. There are however some anomalies. The first is that separate registrations are maintained for trustees in bankruptcy and liquidators. Although no data on the issue seems to be available anecdotal observation suggests that most registered trustees are also registered as liquidators. Most will be members of the professional association, the Insolvency Practitioner's Association of Australia. Accordingly it can be asked why it is not possible to have one registration authority for insolvency practitioners? Arguments about the merging of personal and corporate insolvency regimes have been made previously[6] and have not been acted upon. Historically it was more difficult to achieve than it is now where all corporate law is regulated at Commonwealth level. However, we suggest that even if it is not feasible to integrate all of insolvency regimes under the one supervisory authority, it is possible to place the registration and supervision of the profession under one body. We point to the fact that the eligibility criteria for registration is fundamentally the same: These include

- Be a natural person;

[5] Brown D and Symes C 'Achieving 'better' insolvency practice by using a code as part of Australia's corporate legal framework' Unpublished paper presented to Corporate Law Teachers' Association National Conference, University of South Australia, Adelaide, 8th February 2010

[6] See discussion and references in Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a stocktake* (2004, Commonwealth of Australia) at [12.73]-[12.83].

- Qualifications three years of study in accountancy with two years commercial law study;
- Experience in the relevant areas of insolvency work;
- Being fit and proper;
- Being capable to perform the role as insolvency practitioner;
- Having an appropriate level of insurance;

29. Whilst there is no clear evidence of a lack of appropriate standards being enforced by ASIC, it is clear that ASIC is focused on a large number of diverse functions. Many professions have their own registration boards (albeit mostly at state level). There are models for the establishment of a registration board which operates with a registration fee that provides a cost recovery basis of operation. If necessary it would be possible for separate rolls to be kept for registered liquidators and registered trustees in bankruptcy though the preferred position is to have a fused set of registration and supervisory arrangements. A second area of anomaly is that the current supervisory board is a single one comprising Auditors and Liquidators. It may be asked if this combination remains an appropriate mix given the increasing specialisation of the insolvency industry. There are clearly historical reasons for this combination and whilst it possible that some advantages accrue by having experienced accountants from another area of practice (auditing) sitting on the board to judge the appropriate level of behavior for insolvency practitioners, it seems to limit the level of direct expertise that might be available. It is our submission that that a separate supervisory board for liquidators would be beneficial, particularly one that included trustees in bankruptcy.

30. A restructure in this way ought to consider the means that complaints about behavior can be raised with the supervisory board. Currently it appears that the process is designed for complaints to be lodged initially with ASIC. ASIC then investigates the complaint and where justified will raise matters with the CALDB.[7] The question then arises as to the basis that ASIC refers matters to the Board? It is not possible to say if this has been done adequately because of the lack of data. However if the view is that complaints are not being adequately acted upon, the process can be altered. On the one hand, for reasons outlined above, the nature of insolvency dissatisfaction and blame-shifting is likely to be common. Therefore there is no justification in taking every complaint to a disciplinary hearing. There needs to be some form of filtering process. The question is how to best achieve this. An entity focused upon insolvency and insolvency practitioners may be in a better position than the broadly focused ASIC to evaluate complaints and it may also work in a more timely manner. A further option is to allow responsible professional bodies the standing to directly bring complaints against an insolvency practitioner to the board. The ability to bring a complaint directly to the board may speed up the process.

[7] See s 1292(2) *Corporations Act 2001 (Cth)*

The responsible bodies might be the Insolvency Practitioners Association of Australia as well as the constitutent accounting bodies. This limited right to bring a complaint to be heard by the board is unlikely to be abused by responsible professional bodies with broad membership. In addition it is always the independent board that makes the decision about the complaint.

31. The question of appropriate standards and training for insolvency practitioners is one that has not received a great deal of attention. Certainly it can be said that the legislative requirements leave significant discretion in the hands of the regulator.[8] The gap has been filled by the *Regulatory Guide 186 External Administration: Liquidator Registration* provided by ASIC. This does set out in some detail what is required to be registered initially. However, there is less detail in terms of the requirements to remain registered. These are more general in nature. There does not appear to be significant emphasis on maintaining up to date knowledge although it is recognised that it is required that CPD activities be undertaken as required by professional bodies and the requirement to continue to undertake administrations. It does not for example set standards by way of hours for CPD. The general thrust is that it is quite general in nature. Whilst this has an advantage in terms of flexibility it also leaves room for certain amount of leeway in determining if the standard has been breached.

32. The performance standards set out in *Schedule 4A* of the *Regulations* to *Bankruptcy Act 1966 (Cth)* provide a more specific set of guidelines. Under s 155H(1)[9], the Inspector General may require a written explanation from a trustee as to why his or her registration should be continued if the Inspector General believes that the standards have not been complied with. Whilst it is expected that most practitioners follow these standards as a matter of course, having them detailed in this way helps remind practitioners what is expected in specific statements and assists the identification of persons not maintaining appropriate standards.

*33. T*he Insolvency Practitioners Association has provided a Code of Professional Practice for members to comply with. That document partly provides standards – for example in respect of dealing with remuneration - although in some respects it is also a "how to" manual. It has been recognised in several cases as reflecting the required standards in the profession.[10] It seems possible for the development of a set of standards similar to those in Schedule 4A to be stated for corporate insolvency procedures as well by working with the Code of Professional Practice and other requirements in the legislation. The development of a set of standards at a regulatory level - endorsed by the leading professional association/s - will move us forward from the generalist statements now

[8] See s 1282 *Corporations Act 2001 (Cth)*

[9] *Bankruptcy Act 1966 (Cth)*

[10] See for example *Bovis Lend Lease Pty Ltd v Wily* (2003) 45 ACSR 612 (at [165]), *Gould v CALDB* [2009] FCA 475

available. By articulating these, the legislation can then set out in a more effective manner the minimum expected of liquidators. This might be supported by ongoing audits of insolvency practitioners to ensure that the standards are being met. Further where complaints are made about a particular practitioner, the complaint can be reviewed in the light of the relevant standard. If there is prima facie evidence of a breach of the standard then that will give rise to further investigation and ultimate review of the registration.

34. Finally we suggest that the professional structure of those being regulated will play an important part in setting the tone of a profession. The insolvency practitioner in Australia is a part of the accountancy profession by legislative requirement. The main body that has represented liquidators has grown out of the accounting professional organizations. Historically the Insolvency Practitioners Association (IPA) has been confined in its role as far as discipline and standard setting is concerned. There has in our view been an increasing emphasis on the maintenance of standards since the development of the Code of Professional Practice. As the profession has become more specialised and has separated from other types of accounting work, we suggest there is a need for the IPA to play a more regulatory role. We have suggested above therefore that it ought to be given the ability to directly bring matters before the disciplinary board. For several years membership has required two one-semester units of study at post-graduate university level and workshop participation. The curriculum has recently been reviewed and more emphasis placed upon professional standards. An additional ethics component has been added in the form of a research essay. We suggest that this may assist and that the changes ought to be allowed some time to flow through to the behavior within the profession.

CONCLUSIONS

35. We argue that there is a serious lack of appropriate data upon which to judge most of the matters relevant to this inquiry. The lack of data is a matter that needs to be dealt with in a comprehensive way so that there is confidence in information about the perceived problems and the policy that results. We note that any insolvency is likely to draw forth dissatisfaction and even blame shifting so that it is even more important in this area to have detailed data to objectively determine whether procedures may be improved or not. It appears that some change can be justified in the structure of insolvency practitioner regulation. We argue strongly for a development of a registering authority for all insolvency practitioners separate from ASIC whose multitude of functions now obscures the important function it has in this area. We argue that the relationship with registered trustees in bankruptcy makes it appropriate that one authority be responsible for registering and supervising both trustees and liquidators. We further argue that the professional bodies representing insolvency practitioners are given the right to apply to the registering authority to have persons removed from the register where they believe

wrongdoing has occurred. There is also room to develop clear performance standards in conjunction with the representative bodies to provide guidance and information about what is required and that these have the necessary regulatory authority to ensure their effectiveness.