31 May 2012

Mr T Bryant
Committee Secretary
Senate Economics Legislation and References Committees
Parliament House
CANBERRA ACT 2600
AUSTRALIA

By email: economics.sen@aph.gov.au

Dear Mr Bryant

Inquiry into the post-GFC banking sector

The IPA is the professional body of company liquidators and bankruptcy trustees, and lawyers, financiers, academics and others concerned with insolvency law and practice. We make this submission on the law and practice of 'receivers',[1] in order to assist the Committee understand the role that members of the insolvency profession, who act as receivers, play in relation to the banking sector. In that respect while the terms of reference do not appear to deal with this aspect, we have noted that some submissions to date have raised the role of receivers acting on behalf of banks in selling assets of the banks' customers.

This submission therefore seeks to assist the inquiry in understanding that role.

We note that in the Economic References Committee's 2010 report on liquidators and administrators, a short explanation is given on receiverships[2] although the Committee's report did not deal with that particular role.

1 What is a Receivership?

A "receivership" is an administrative procedure by which a person – who must be a registered liquidator - is appointed to administer property on behalf of a secured creditor. The secured creditor, often but not always a bank, appoints the receiver. The appointment may be limited to mere protection of one particular item of property – for example factory

[1] Throughout this submission, the term 'receiver' is used which is the common usage, and we use it to include a 'receiver and manager'. The distinction between them mainly relates to the extent of their powers. The Corporations Act – *Part 5.2 Receivers, and other controllers, of property of corporations* - uses slightly different terminology – "controller" and "managing controller".

[2] *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, 14 September 2010

premises - or it may extend to general control over all of the property and business affairs of a company – for example the factory and the engineering business carried on there.

A receiver may be appointed privately under contract, or by the Court. We only deal with the former which is by far the most common type of receivership and the type that is relevant to this inquiry.

A bank is invariably a secured creditor, meaning that the customer has been required to give some form of security as a condition of the loan, to protect the bank's position in the event of its customer's default. The security might be, for example, a mortgage over particular real property or it might be a registered security interest over some or all of the assets of the customer. The mortgage or security document sets out the rights and obligations of the debtor (the customer who owes the bank money) and creditor. It is commonly a condition of the loan being given by the bank that it have the right to appoint a receiver and sell the customer's assets if the customer defaults. This is standard loan policy and applies in the majority of commercial property and home loans.

Although the receiver is appointed by the secured creditor, the security document provides for the receiver to be appointed to act as agent for the customer. In this way the secured creditor does not itself become a 'mortgagee in possession' and thereby become directly responsible for liabilities attaching to the secured property. The receiver is also typically given an indemnity by the secured creditor in relation to any liability found against the receiver, but this usually contains exceptions in relation to the receiver's negligence or fraud, leaving the receiver personally liable if that occurs.

The purpose of the appointment of a receiver by a bank as a secured creditor is to take control of the assets of the bank's customer. The receiver must then decide how best to satisfy the debt owing to the bank. While the receiver will take instructions from the bank on how this may best be done, the receiver has serious responsibilities under the Corporations Act 2001 that they must comply with.

Central to this is the obligation under section 420A of the Corporations Act. It provides that in exercising a power of sale in respect of property of a company, the receiver must take all reasonable care to sell the property for - if, when it is sold, it has a market value-not less than that market value. Otherwise, the receiver must obtain the best price that is reasonably obtainable. This duty applies having regard to the circumstances existing when the property is sold. The duties of a receiver as an 'officer' of the company – good faith, honesty, avoidance of conflict – also apply during the receivership.

2 A bank's appointment of a receiver

The most common default leading to the right to appoint a receiver is failure to make a repayment on a due date. There can also be non-monetary defaults such as failure to provide accounting information as agreed, dealing with specified assets contrary to the loan agreement such as by unauthorised factoring of debtors or not meeting certain debt/equity ratios.

The security documentation may also include the requirement that the secured creditor give notice of default to the borrower company in order to provide it with the opportunity to remedy the default before any receiver is appointed.

Once the necessary pre-conditions are satisfied, the secured creditor can proceed and appoint a receiver without reference to the courts or any other regulatory authority. The normal method of appointment is for the secured creditor to find a receiver who is prepared to act and then execute a deed of appointment. It is usually a very simple and quick procedure.

In reality, many of our members are involved in assisting the bank in reaching its decision whether to appoint a receiver. They may be instructed to do an investigating accountants' report for the bank, which involves the practitioner conducting an extensive review of the company's business to determine whether and when a formal appointment of a receiver

may be needed. It may be the case that the practitioner will recommend some changes to the operations of the business that will restore its performance and allow the bank to be satisfied that its debt will in fact be repaid. Alternatively, the practitioner may recommend that the company attempt to refinance its facility with an alternative lender.

For completeness, it should also be noted that section 436C of the *Corporations Act* also enables a secured creditor with a security interest over all or most of the company's assets to appoint a voluntary administrator under Part 5.3A of the Corporations Act. This is an alternative approach available to a bank in that circumstance.

3 Practical role of a receiver

No two receiverships are the same and will depend very much on the type of business and the nature of the assets involved. Typically, a receiver will take possession of the property or business assets and then analyse the company's business position with a view to adopting the best course of action to enable repayment of the secured creditor's debt.

In some instances, this may involve trading on the business with a view to repaying the bank as secured creditor without major asset sales. This may further involve the receiver in working to build up the business for a period of time so that it can be sold for a good price as a going concern.

In other instances, the receiver may decide to sell some or all of the assets of the company to try to recoup the secured creditor's debt.

Generally, the receiver will normally consult with the secured creditor before the major assets are sold to ensure that there is no objection to the proposed method of sale and price. However, the receiver must at all times have regard to their statutory duty of sale under section 420A of the Act. Moreover, if the secured creditor seeks to control the conduct of the receivership, the position of the receiver as agent of the borrower can be severed, leaving the secured creditor directly liable for the receiver's conduct. This legal framework is well understood by practitioners.

The sale of assets at market value is a significant legal obligation of a receiver and it is one that is sometimes contested in the courts. This action may be taken by the directors based on their claim that the receiver did not sell their business for the best price. Directors and others are entitled to take these challenges but we find that the owners of the business often have an overly optimistic view of the value of the business, and a limited sense of their responsibility for its decline. Also, questions of market value are often contentious, more so in what we may call a post GFC climate when expectations of sale price have to be adjusted. The law generally requires receivers to engage in a competitive process, for example, involving tender or auction, and based on valuation and sale advice. Assets sold by receivers also attract those looking for a reduced price. Most court challenges to receivers' sales do not succeed.

4 Personal liabilities of the receiver

In common with other types of insolvency administration, receivers have personal liabilities imposed upon them under the Act. For example, they can be personally liable for rent payable by the company under a lease of premises. The receiver has a 7 day period to make a decision whether to continue to lease the property, beyond that, personal liability is imposed. This means that prompt decisions have to be made by the receiver about the business, for example whether it is worthwhile to continue to rent the premises from which it operates.

Wages of employees of the company can also be the personal liability of the receiver. As to employees, it may often be that, even if the business is traded on, the services of some employees will have to be terminated as being excess to the business' requirements. The receiver can be personally liable also for worker health and safety; this is another reason why a receiver will often have to make a quick decision in deciding whether the business has been meeting its obligations to employees and whether trading should or can be continued.

5 Directors' obligations

Once a receiver is appointed, the directors' powers over the company assets cease. However, the directors' normal statutory responsibilities continue, including in relation to the company's statutory reporting obligations. In particular, a director is required to submit a report as to affairs to the receiver, in the same way that directors of companies in liquidation are also required. Section 590 of the Act provides a listing of obligations of directors in assisting the receiver, and potential offences for non-compliance. It applies to receiverships in the same way as it applies to liquidations.

6 Effect on unsecured creditors

The main purpose of a receivership commenced by private appointment is to repay the secured creditor's debt. Given this, it is not the duty of the receiver to convene meetings of unsecured creditors or provide reports to the unsecured creditors about the conduct of the receivership. It is this misunderstanding of the role of the receiver which can lead creditors and directors on occasion to feel aggrieved and cause them to say that a receiver has acted inappropriately or may not have discharged their duties correctly. It should also be noted that even if there are surplus funds after payment of the secured creditor's debt, a receiver does not have authority to distribute those funds to ordinary unsecured creditors. In that respect, liquidations and voluntary administrations are the regime that primarily serve the interests of unsecured creditors.

7 Roles of liquidators and administrators in conjunction with receivers

Those unsecured creditors may in fact decide to commence winding up proceedings against the company and they will often do so; or the directors themselves may initiate the company's voluntary winding up. As an alternative, the directors may decide to appoint a voluntary administrator to the company. In that instance in particular, a bank may choose to appoint a receiver and have the receiver act to sell the secured property despite the voluntary administration; or the bank may chose to await the outcome of the voluntary administration process before exercising its rights.

It is therefore quite common for both a receiver and a liquidator or administrator to be appointed concurrently to the same company, each with their different roles.

7.1 Example

As a very recent example, banks appointed partners of McGrathNicol as receivers & managers over companies in the Hastie Group. At the same time, partners of PPB Advisory were appointed as voluntary administrators of those and other companies in the Group. Each firm has information on its website[3] which explain their respective roles.

8 Remuneration

Receivers are in effect paid from the sale of the assets of the company, or by the bank if those assets are insufficient. The secured creditor will normally set the rates by which the receiver is to be paid. The right to do so is usually spelled out in the security agreement the customer signs, but the remuneration of the receiver can be challenged and reviewed by the court on the application of ASIC or of a subsequent liquidator or administrator.

9 IPA Code

The IPA Code of Professional Practice sets standards of conduct required of IPA members. These include members when they are acting as receivers. While liquidators and administrators have standards of conduct in relation to their independence and their fiduciary duties, a receiver is different in that he or she acts for a bank to whom a duty is owed to assist in recovering the bank's debt. Notwithstanding the receiver's duty to the appointing secured creditor, the law imposes some overlaying duties of a receiver to the company itself, and to the interests of unsecured creditors. This is recognised in the IPA Code.

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[3] http://www.mcgrathnicol.com/news/Documents/Hastie%20-%20MediaRelease%20280512.pdf

http://www.ppbadvisory.com/news/d/2012-05-28/ppb-advisory-appointed-administrators-by-hastie-group

10 Current reforms about receivers

At present, the law requires a receiver to be registered with ASIC as a liquidator, just as a voluntary administrator must also be a registered liquidator.

The government insolvency proposals paper of December 2011 proposes a new separate registration of persons as receivers only.[4] The rationale given is that there are many people in the insolvency industry who currently specialise in receivership whose skills and experience well qualify them for that work, but which are not enough to allow them to work as a liquidator. The IPA has opposed the reform on the basis that while a receiver may have different fiduciary and other obligations to a liquidator or administrator, receivership often involves intersection with other external administrations, and duties owed as an officer of the company, and to unsecured creditors. It is also often the case that receiverships can be very complex, more so than many liquidations. The IPA considers that it is important that persons appointed as receivers have the same broad qualifications and experience as other insolvency practitioners and have detailed knowledge of the other forms of insolvency administration.

11 Further comment or assistance

We trust these comments on the nature of receiverships and the role, powers and responsibilities of a receiver are helpful. Should other issues arise in the inquiry in relation to the role on which the Committee considers we could assist, we would be pleased to do so. This includes more detailed issues about the law or practice, or about particular receiverships that are raised in submissions where the Committee considers IPA's view would assist.

Please contact either myself, or the IPA's Legal Director,
- as necessary.

Yours sincerely

Robyn Erskine
President
Insolvency Practitioners Association

[4] *Proposals paper: A modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia*, December 2011