Law Council
OF AUSTRALIA

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26 September 2003

Dr Kathleen Dermody
Secretary
Parliamentary Joint Committee on
Corporations and Financial Services
Parliament House
Canberra ACT 2600

Dear Dr Dermody

Inquiry into Australia's Insolvency Laws

I am writing to you to follow up requests for information made by members of the Parliamentary Joint Committee on Corporations and Financial Services when the Law Council appeared at the Committee's hearing on 14 August 2003 in relation to the above Inquiry into Australia's Insolvency Laws (the "Inquiry"), and also to provide some additional responses.

The concept of "insolvency practitioner"

"Insolvency practitioner" is a term used to describe professionals working in the insolvency area, including liquidators and lawyers. This broad use of the term "insolvency practitioner" has been recognised by the Insolvency Practitioners Association of Australia ("IPAA") broadening its membership, so as to allow lawyers to become full members of the IPAA (which the Law Council supports).

However, the Law Council wishes to clarify that while the concept "insolvency practitioner" includes liquidators, it is not synonymous with liquidators. "Insolvency practitioner" is a broader concept.

The Law Council notes statements by Mr Bruce Carter, the President of the IPAA, at pages CFS 221 and 222 of the *Hansard* for this Inquiry (the "Inquiry *Hansard*"). It must be understood that being an "insolvency practitioner" or a member of the IPAA is distinct from being a registered liquidator. The Law Council recognises that Mr Carter was not suggesting otherwise (see in particular the statement "*ASIC determines who becomes a registered liquidator ...* [i]*n other words, it is not a requirement to be registered to be a member of the IPAA*").[1]

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1 Inquiry *Hansard* at page CFS 222.

The Law Council particularly wishes to qualify the following statement of Mr Carter (at page CFS 221 of the Inquiry *Hansard*):

> "*Mr Carter – As I said, solicitors and lawyers form a very important part of our organisation. If they are to be registered as liquidators, we have no opposition to that whatsoever. A number of lawyers already are.*"

The Law Council understands that the number of lawyers who already are liquidators is one, being a Queensland lawyer who is also a chartered accountant. This supports the Law Council's contention that the current provisions are too restrictive, and in reality ensure that there is a "closed shop".

The Trade Practices Commission report

At the hearing on 14 August 2003, the Law Council referred to a report by the Trade Practices Commission, *Accountancy: Study of the Profession, Final report – July 1992*. Please find **attached** a copy of pages 63-74 of that report.

The Law Council notes the following observation made by the Trade Practices Commission:

> "*Accepting that most official liquidators come from the major accountancy firms or specialist insolvency firms, the present registration requirements would appear not only to prevent competition from outside the* [accountancy] *profession, but also to impede competition from outside the established insolvency firms.*"[2]

The Law Council again draws attention to the conclusions of the report in relation to registration of liquidators:

> "*It is arguable that some form of regulated entry barrier is warranted to protect the public interest. However, that does not necessarily lead to the conclusion that those concerns can be met only be licensing with the stringent entry criteria that presently exist. As noted above, self-regulatory and statutory supervision of practitioners can be used to maintain ethical and professional standards.*
>
> [T]*he information available does not support the present tight restrictions but rather suggests that many insolvency administrations could be effectively administered by those with alternative experience.*
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> *It is evident from the comments and submissions to the study that the role of an insolvency practitioner in Australia today is only indirectly linked to the accountancy profession. The fact that some accounting skills (although often not necessarily of a high order) will be essential in any administration,*

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2 Trade Practices Commission, *Accountancy: Study of the Profession, Final report – July 1992* at page 69.

does not necessarily justify confining registration to a narrow group of professionals.

Conclusion and recommendation

The conclusion, on the available information, is that a licensing approach to insolvency management may assist in protecting third parties from the effects of inadequate administrations. It is not the only measure needed, however, and needs to be complemented by ethical and professional standards. Moreover, it is not clear that the existing restrictions on registration need to be as onerous as they are to achieve this objective, particularly as they appear to prevent entry to the profession by practitioners who could provide additional competition and therefore incentives for economy and efficiency among practitioners.

It is recommended that the present narrow entry requirements be broadened to reduce their present restrictions on the potential for competition from a wider pool of appropriately qualified practitioners. It is important to retain flexibility on where prescribed experience must be obtained and also on who might be competent to perform less complex administrations."[3]

Over a decade after the Trade Practices Commission's report, the situation remains unreformed, and the recommendation remains relevant.

The entry requirements for registered and official liquidators

Senator Andrew Murray asked the Law Council following question in relation to entry requirements for registered and official liquidators at the Inquiry hearing on 14 August 2003: "*how or by what means would we as a committee recommend the criteria, certification or licensing or whatever system you propose to be devised in a less regulated but still prudential manner?*"[4]

At the hearing on 14 August 2003, the then President-Elect, Mr Bob Gotterson QC, said (at page CFS 191 of the Inquiry *Hansard*) that:

"We envisage that lawyers who are experienced in insolvency or commercial practice will be the ones who would qualify as liquidators. This is not a pitch for all lawyers, just because they are lawyers, to be eligible to be liquidators. We acknowledge that there is a need for specific rules about levels of previous experience and the undertaking of specific courses of study in liquidation. Consideration has to be given to those, and we acknowledge they would be part and parcel of any reform. We are concerned that the criteria, when ultimately settled, are not so overly

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3 Trade Practices Commission, *Accountancy: Study of the Profession, Final report – July 1992* at pages 72-73 (footnotes omitted).

4 Inquiry *Hansard* at page CFS 199.

prescriptive as to effectively amount to a barrier to lawyers entering the market."

In broad terms, what an applicant needs to be able to do to be a liquidator is, the Law Council would say, well known. As the Law Council said in its original written submission of February 2003 in relation to this Inquiry: "*The key requirement is the ability to understand the needs and entitlements of a company's creditors, employees, shareholders and other parties and how to achieve the realisation of the assets of a company's operations to best match those entitlements*".[5]

In terms of specific amendments, the Law Council believes there should be amendments to section 1282 of the Corporations Act and to Policy Statement 40.

In relation to section 1282 of the Corporations Act, the Law Council believes that the references to membership of accounting bodies and accounting qualifications, in sub-paragraphs 2(a)(i) and 2(a)(ii) respectively, should be amended to refer to membership of legal professional bodies (namely the Law Council of Australia and its constituent bodies) and legal professional qualifications.

To cater for suitable persons who are neither lawyers nor accountants, there should be a broad discretion for ASIC to consider other qualifications and professional memberships, or to dispense with a requirement in a particular case.

With respect to the "experience criteria" set out in Policy Statement 40 the Law Council suggests amendments so that paragraph 4 of the Policy Statement would be deleted, and paragraph 3 would read along the following lines.

Experience criteria
[PS 40.3] An applicant must:

(a) have had at least five years of appropriate accounting and/or commercial law experience; or
(b) have obtained a wide range of experience in external corporate administrations under the direction of an official liquidator for a continuous period of not less than three years, including windings up, receiverships, reconstructions and voluntary administrations; or
(c) other managerial experience considered sufficient by ASIC..

This experience will be taken into account whether under the Corporations Law or the previous law and whether or not those periods were overlapping or concurrent.

[PS 40.4] – Delete provision.

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5 *Law Council of Australia Submission to Parliamentary Joint Committee on Corporations and Financial Services* at page 7.

Above, the Law Council has referred (in relation to Corporations Act section 1282) to the inclusion of a broad discretion for ASIC to consider other qualifications and professional memberships. Some guidance as to what would be appropriate can be found in the United States practice in relation to the appointment of bankruptcy trustees for company liquidations.

Panel Trustees in the United States

In federal bankruptcy cases, liquidation of corporations is undertaken by a "trustee", appointed by a federal administrative agency, the Office of the United States Trustee. The National Association of Bankruptcy Trustees has the following description of trustees on its website (www.nabt.com):

> "*How and why is a Trustee appointed to a Chapter 7* [liquidation] *bankruptcy case?*
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> *After the bankruptcy petition is filed, the Unites States Trustee appoints as trustee a disinterested person who is a member of a panel of Chapter 7 trustees ("panel trustee") to serve as an interim trustee. The interim trustee serves until a permanent trustee is elected or designated at the Section 341 hearing....*
>
> *Who is a Chapter 7 Panel Trustee?*
>
> *A Panel Trustee is appointed by the United States Trustee. A person is appointed to a panel of trustees usually in the locality of the office of the United States Trustee in which the person resides. Each Panel Trustee must pass a FBI background check and is required to post a bond in each case that he/she is appointed. Most Panel Trustees qualify for a blanket bond which covers them in each of the cases that they are appointed. The United States Trustee is responsible for the selection of panel members. Each United States Trustee office has its own qualifications for selecting a Panel Trustee. Usually individuals interested in serving as a Panel Trustee files a resume with the United States Trustee to be reviewed when selecting a new panel member. The selection of a Panel Trustee by the United States Trustee should be a non-political process. Panel Trustees are varied in experience; however, most Panel Trustees are lawyers, accountants and individuals experienced in business such as bankers, insurance agents, appraisers, real estate or investment brokers.*"

The Law Council understand that creditors can vote in a different trustee who need not be a member of the Panel of Trustees. The basic pool of trustees, however, is the Panel Trustees – and the range of professions listed above provides a good indication of the professions whose experience might be considered relevant – in addition to lawyers and accountants – under a broad "business" discretion. ASIC would be assisted in its individual decisions under such a discretion, as in other matters, by guidance documents decided on by an advisory body.

Membership of advisory body to ASIC

In the Law Council's submission, it recommended:

> *"That if ASIC is to continue to act as the principal regulatory authority for liquidators, then an advisory body to ASIC be established in relation to ASIC's functions on the appointment, registration and removal of liquidators and the maintenance of professional standards. Membership of the advisory body should be drawn from professional bodies such as IPAA, ICAA, ASCPA and the Law Council of Australia."*[6]

At the hearing on 14 August 2003, there was the following exchange between the Chair of the Law Council Business Law Section's Insolvency and Reconstruction Law Committee, Mr Jon Clarke, and Senator Murray:

> *"**Mr Clarke** - ... we refer to the Law Council recommending the establishment of a formal mechanism through which a number of professional organisations would play a direct advisory role to ASIC to set the standards for admission and supervision, and also for taking away the licence of a liquidator.*
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> ***Senator Murray** – Yes; I saw that, Mr Clarke. But my fear was that, if it is the same bodies who want to hold the closed shop – or perhaps enlarge the closed shop a little more – we have the same problem. So, if you want to open up to competency alone and not just to professional certification as a lawyer or accountant, you would need to make sure that the people devising it were not just lawyers or accountants. That is really my point. Perhaps, rather than pursue it at length – and I hesitate to do it if the Law Council was not able to – if you felt you could think a little more and, perhaps, come back to us with a view of it, I would be grateful."*[7]

Taking up Senator Murray's invitation, the Law Council now suggests, in addition to those bodies identified above, that there be representative on the proposed advisory body that reflect the broader community interests in the liquidation system, such as:

- a representative of institutional investors and/or shareholders;
- a representative of lenders;
- a representative of the trade union movement, given the role of employees as creditors;
- a representative of small business and a representative of business more generally; and

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6 *Law Council of Australia Submission to Parliamentary Joint Committee on Corporations and Financial Services* at page 5.

7 Inquiry *Hansard* at page CFS 199.

- the flexibility to include a representative of any other professions in addition to lawyers and accountants who become a major source of liquidators (eg if real estate agents took on a significant share of the liquidation market, then it would be appropriate for there to be a representative of real estate agents).

Fee competition if entry requirements for registered liquidators are liberalised

The Chairman of the Committee, Senator Grant Chapman, asked the following question of the Law Council: "*Given that there is also [in addition to concern about liquidators' fees] general concern about lawyers' fees, how will bringing more lawyers into the operation as liquidators serve to be beneficial in reducing the costs of administration?*"[8]

The Law Council would say that, generally speaking, increasing the number of suppliers by itself should lead to downward pressure on fees. Both the Trade Practices Commission and the Working Party on the Review of the Regulation of Corporate Insolvency Practitioners took the view that opening up the liquidation services market would at least potentially ameliorate prices.[9]

Mr Clarke made the observation at the hearing of 14 August 2003 that: "*What is happening at the moment is that it is exclusively for the accountants and they are really setting their own rates, which, state by state, no matter whether the practitioner is from a large firm or a small firm, tend to be about the same level*" (Inquiry *Hansard* at page CFS 197). In the Law Council's view, legal fees would generally tend to be more flexible than those of liquidators.

There are 836 registered liquidators in Australia, of whom 361 are also official liquidators.[10] Even a small number, in absolute terms, of additional liquidators could be expected to have a dampening effect on fees given the current number of registered liquidators.

Comment by Professor Keay

Professor Andrew Keay made the following comment in response to a question from the Chairman of the Committee, Senator Chapman, as follows (Inquiry

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8 Inquiry *Hansard* at page CFS 196.

9 Trade Practices Commission, *Accountancy: Study of the Profession, Final report – July 1992* at page 77 in particular. Working Party on the Review of the Regulation of Corporate Insolvency Practitioners, *Review of the Regulation of Corporate Insolvency Practitioners: Report of the Working Party* at 82: "[I]*t is also important that the restrictions imposed* [on entry] *do not form unnecessary impediments to competition within the market for insolvency practitioners' services. Anti-competitive effects can result in unnecessarily high costs and reduced efficiency*".

10 Australian Securities and Investments Commission, *Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Australia's Insolvency Laws* at page 5.

Hansard at page CFS 216):

> "***Chairman*** *– ... The Law Council of Australia has suggested that the criteria be broadened to allow more lawyers to participate as administrators and liquidators. Do you have any views on means of widening the pool of potential administrators and liquidators ...*
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> ***Prof Keay*** *– I do not know whether broadening it to allow solicitors to take on the role would help, in many ways. I know that in the United Kingdom, where there is the possibility of not only accountants but also solicitors being licensed as insolvency practitioners, very few of them do any administrations because they find that their offices are not set up to handle that type of work. ... We know from the past, I think, that with part X applications under the Bankruptcy Act, it was possible for solicitors to call a meeting of creditors of an individual and act as the trustees for a part X arrangement. I know, from my experience when I was a registrar in the Federal Court, that there were real problems with certain solicitors handling that, from a number of perspectives. So I do not know whether that would solve the problem and make it better.*"

The Law Council would say that liberalisation of the entry requirements for registered and official liquidators will allow conditions for a new component of providers, lawyers and others, to develop within the market for liquidation services. As the component grows so too would the capacity of those providers within it. A low take up in the United Kingdom, prompts the questions whether the level of liberalisation is not sufficient there, and whether the approval requirements are too restrictive.

Professor Keay's comment about problems with individual solicitors when he was a Registrar of the Federal Court is too general for the Law Council to respond to.

However, the Law Council notes that although it would expect that lawyers will need to obtain their own specific insurance in relation to liquidation services (in addition to their existing compulsory professional indemnity insurance) that generally speaking it would expect the consumer protection mechanisms that ordinarily apply now to lawyers (such as in relation to fee disclosure and disputes, and complaints and discipline mechanisms generally) to apply in their role as liquidators.

The Law Council notes that it would also not expect fidelity funds (which, in broad terms, compensate clients whose money is stolen by a lawyer) to cover the work done by lawyers as liquidators.

Independence issues

The Law Council thanks the Committee for time to consider the issue of independence of insolvency practitioners raised by Senator Murray at the hearing

on 14 August 2003. Senator Murray asked the following question (Inquiry *Hansard* at page CFS 200).

> *"To summarise my question: the issue of independence is now a core issue in operating companies – ensuring independence is there in the manner in which accounts and accountability are pursued. The flip side must be there in the insolvency area as well, I would have thought – you outsource for an auditor or a valuer and so on. Are there sufficient checks to make sure that there is sufficient independence? It is a much bigger issue in Corporations Law generally now, and I wondered if it was, or if it should be, also attended to insolvency law?"*

The independence of an insolvency practitioner from his or her appointee or any agents contracted by the insolvency practitioner such as lawyers, valuers and other consultants, is an issue that requires review.

Most insolvency practitioners are aware of their obligations of independence and comply with the provisions of the law and the Statement of Best Practice prepared by the IPAA.

Section 532 of the Corporations Act prescribes the circumstances in which an insolvency practitioner must not seek an appointment as liquidator to a company (namely if there have been certain financial or professional dealings with the company). Section 448C of the Corporations Act provides similar prescriptions with respect to insolvency practitioners seeking to be appointed as voluntary administrators.

The IPAA has set out in their Code of Professional Conduct ("IPAA Code") guidelines with respect to conflicts of interest. They provide that no insolvency practitioner shall consent to act after a review of all information available that a conflict may arise during the appointment or during the administration unless all relevant parties including the Court where appropriate, are advised of the possibility of such a conflict. An insolvency practitioner should not seek the appointment as a liquidator, provisional liquidator, controller, scheme manager or administrator if during the previous 2 years that person had a professional relationship with the company (that existed for a period of 2 months or more) or had been appointed auditor of the company. The IPAA Code states that members should use discretion in the manner and degree by which they seek an appointment and should be careful to avoid the creation of obligations to or by those responsible for an appointment.

The IPAA Code is also referred to in the IPAA Statement of Best Practice dated 1 July 2003 which applies to the appointment of Administration pursuant to Part 5.3A of the Corporations Act.

The Law Council has concerns about the independence of some administrators and liquidators who have provided a company with pre-appointment advice. There is the public perception that the appointment may lead to a conflict

because advice that has been given during the pre-appointment period will not be scrutinised or be made subject to criticism.

The Law Council believes that the prescriptive provision set out in 548 and 532 of the Corporations Act should be expanded to prohibit the seeking of an appointment in circumstances where:

- there has been a continuing professional relationship; or
- there has been pre-appointment advice provided to the company.

And the Law Council believes that there should be a prohibition against an insolvency practitioner being given directly or indirectly, benefits by third parties for their appointment as a liquidator/administrator or for engaging particular agents (such as lawyers, valuers and other consultants).

Further contact

The Law Council would be pleased to provide any further information that would be of assistance to the Committee. Please contact me on 6246 3788, or the Law Council's Mr Greentree-White on 6246 3715, if there are any further queries.

Yours sincerely

The Hon Michael Lavarch
Secretary-General

Trade Practices Commission

Study of the professions

Final report — July 1992

— Accountancy —

2. Specific areas of accountancy

Insolvency

An important part of the Commission's examination of the accountancy profession has centred on the specialised area of insolvency practice. This involves the administration of the financial affairs of either an individual (in Australia termed bankruptcy) or a company (winding-up, receivership, etc). It is a professional activity that has been in the public eye in recent years, particularly in relation to large corporate collapses and the current recession which has increased both corporate and personal insolvencies.

The Law Reform Commission (LRC) conducted an inquiry into insolvency, making many recommendations in a report released in 1988.[127]

Insolvency practice

Insolvency practices initially grew from the appointment of liquidators and receivers in cases of corporate insolvency. Private practitioners are also involved in personal bankruptcy.[128] Both corporate and personal insolvency are regulated by statute: the *Corporations Law* for corporate insolvency and the *Bankruptcy Act* for personal estates.[129]

An insolvency practice in Australia will commonly be involved in a number of activities including windings-up, provisional liquidations, receiverships, bankruptcy, schemes of arrangements and other non-regulated functions such as reviews of a bank's loan portfolio. A detailed description of the various functions of an insolvency practitioner is contained in Attachment 3. For the purposes of this analysis the key features to note are:

- the nature of the functions to be performed;
- the different categories of registered liquidator, official liquidator and registered trustee;
- the different functions which can be performed by different categories of practitioner;
- circumstances in which there are private or Court appointments of practitioners;
- the role of the Courts in the appointment of, and setting of remuneration for, practitioners;

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[127] The Law Reform Commission, *General Insolvency Inquiry* 1988, commonly referred to as the Harmer Report. A summary of the relevant portions of the report is contained on page 141 in Attachment 3.

[128] Private trustees have always played a role in Part X arrangements and deeds of assignment. Changes to the *Bankruptcy Act* in 1981 were designed to increase the role of private trustees in bankruptcy proceedings, although, in practice, the vast majority of bankruptcies are administered by the Official Trustees.

- the methods by which practitioners are appointed; and
- the various interests which may be affected by the way in which practitioners perform their duties.

The Commission's study has been hampered by difficulty in obtaining detailed relevant statistics on insolvency practice for both corporate and personal insolvency.[130] Much of the statistical data sought from the relevant authorities and the IPAA simply have not been available. Additional statistical information would be required to more fully analyse some aspects of insolvency practice, including information that would show:

- the size of the market in dollar terms, for example assets involved in administrations, percentage distributions to creditors, amount of remuneration to insolvency practitioners, etc;
- the relative cost of liquidations for which no remuneration is paid to the liquidator compared with the cost of other appointments for which remuneration is paid;
- who receives appointments for the various classes of insolvency administration which might demonstrate the significance of the status of official liquidator in appointments other than compulsory windings up and provisional liquidations; and
- a break up of the number of administrations for specific areas such as official management, schemes of arrangement, and provisional liquidators.

The regulatory regime

Insolvency practice is an area of professional activity in which a number of the 'market failure' characteristics discussed earlier[131] are of potential concern.

A key feature of the administration of insolvent estates and companies in Australia is that, in the case of corporate insolvency, the practitioner takes custody or control of the assets of the company, while for bankruptcy the assets of the estate actually vest in the hands of the trustee. In either case, it is for the practitioner to administer the estate or company to secure the best value possible for any assets sold and the most appropriate distribution to creditors. As noted in the Harmer Report:

> An insolvency practitioner is, above all else, a trustee, of whom the highest standard of honesty, competence, skill and diligence is required.[132]

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[129] The Australian Securities Commission (ASC) has responsibility for administering corporate insolvency and the Insolvency and Trustee Service of Australia (ITSA) performs similar functions for bankruptcy.

[130] This was a handicap also referred to by the Harmer Report which noted that it had difficulty in obtaining *pertinent statistical information about corporate insolvency in a readily available and intelligible form*, and it recommended that better statistics be compiled, ibid paras [36]-[43].

[131] Refer to the brief discussion on *Regulation v competition — a question of balance* page 11 above and the more detailed discussion in the Commission's December 1990 paper.

[132] The Harmer Report *op cit*, para [930].

With such responsibilities given to practitioners, the regulatory regime attempts to ensure that:

- administrations are effective in terms of maximising returns to creditors;
- those likely to be affected by the administration may confidently rely on the expertise and judgment of the practitioner; and
- safeguards over the independence of the practitioner are established.

It does so by imposing various restrictions affecting: the method of entry to the field (registration); the method of remuneration (scale of fees); and, to a lesser extent, the method of appointment (rotation).[133]

These three issues are not mutually exclusive. They each raise competition concerns and the anti-competitive effect of each is likely to be reinforced by interaction with the others. For example, the anti-competitive effect of the scale of fees is reinforced by the profession's very tight entry requirements and by any rotation of assignments which limits competition among established practitioners.

The net effect of the regulation is an exclusive field of activity that has traditionally been, and effectively continues to be, reserved for a relatively small class of service providers from a particular professional discipline[134]. Within the regulated market, any potential for price competition is affected by the use of the scale of fees. For those areas in which it applies, the rotation system also impedes the competitive process.

Registration

The right to practice in insolvency in Australia is regulated by licensing arrangements requiring registration either as a registered liquidator, official liquidator or trustee in bankruptcy. Such an approach represents one of three main options which could be taken to regulate entry to the market, namely: open entry, certification or licensing.[135] Licensing is the most secure method of safeguarding public concerns about quality of service and qualifications of the service provider, but it also involves the greatest cost to market competition because it will usually have the effect of excluding alternative service providers from the market..

Most submissions essentially assume that some form of licensing provides the only method of adequately securing the public interest in insolvency administration. The ASC and ITSA were invited to consider the certification option and both presented strong submissions against such an approach, expressing the view that there would be insufficient controls

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[133] There are also other regulations relating to the nature of the duties and responsibilities of the practitioner. While these are very important in terms of meeting the various demands of insolvency administration, they are not directly relevant to this study and are thus not considered in detail here.

[134] The Commission has been advised of recent changes in the IPAA's membership criteria to allow membership from a wider group of professionals. While such a move is to be applauded, it is not possible to assess what effect, on its own, this change is likely to have on altering the present situation. As will be noted below, the effects of the present restrictions are largely due to the administrative approach adopted by the ASC in assessing relative experience and it is not clear that the IPAA changes will alter this.

[135] A description of how each of these terms is understood is contained in the attached glossary. A brief summary of the approach to insolvency administration in UK, USA and New Zealand is also provided on page 143 in Attachment 3.

available over non-certified operators to adequately protect the public. ITSA in particular stated that the relevant market was not sufficiently well-informed to allow certification adequately to protect the public.[136]

The present requirements[137] include the three broad elements often included in registration

- **Education** — requiring the completion of a minimum standard of education. In insolvency this generally requires completion of predominantly accounting qualifications together with commercial law, including company law, although discretionary powers exist to consider equivalent qualifications.

- **Experience** — requiring that the person have a minimum history of relevant experience which for registered liquidators is prescribed by the administrative requirements of the ASC to be:

  — five years experience in public practice;

  — three years experience in a range of corporate insolvencies under the direction of an official liquidator; and

  — at least two years in the last five supervising corporate insolvencies.

  Registration as an official liquidator requires a further two years experience following registration as a liquidator in insolvency administrations including winding up. The precise experience requirements for trustees in bankruptcy are not spelled out but are likely to include some experience in insolvency administration. For liquidators the ASC's requirements preclude the consideration of alternative experience requirements[138] although for bankruptcy some flexibility is retained, at least in theory, to consider alternative experience.

- **Personal characteristics** — ensuring that the person is a fit and proper person to be entrusted with the responsibilities of the position.

The debate on registration has primarily focused on whether it is appropriate that the field should be reserved for accountants. The Harmer Report recommended that the area not be reserved in this way.[139] The issue for this study may be stated as follows:[140]

> can the public interest be equally or better served with a wider resource pool of suitably qualified and experienced people not necessarily limited to those from a particular professional discipline?

The emphasis on the accountancy profession in insolvency work in Australia has a very long history and has always, at least in the corporate insolvency area,[141] been clearly stipulated

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136 Market information problems do not exist across the entire market and can be confined to smaller administrations where person's of less expertise are involved in appointments. This is further discussed under *Public interest issues* on page 70 below.

137 More detail of the registration requirements is contained on page 136 in Attachment 3.

138 The *Corporations Law* is silent on the criteria to be used to assess relevant experience and thus the ASC establishes its own criteria having regard to the matters it considers are important in securing the public interest and efficient administration of insolvency. The *Corporations Law* itself does give the ASC a discretion to allow alternative experience requirements, however the ASC's present determination precludes that possibility.

139 *op cit* para [937].

140 as stated in the Issues Paper of March 1991.

within the relevant statute. Prior to the introduction of the new *Companies Act* in 1982, and the national registration system for auditors and liquidators, a registered liquidator was, in effect, a registered company auditor registered as a liquidator. The statute thus specifically required that the liquidator also be an accountant.

While the existence of discretionary criteria for educational qualifications permits some flexibility in the selection process for liquidators, the very stringent experience requirements presently prescribed by the ASC ensure that the traditional reservation of the area to accountants remains. The requirement of a substantial degree of experience in corporate insolvency and under the supervision of an official liquidator ensures that the class of practitioners is, even within the accountancy profession, further narrowed.

It is important to bear in mind that the experience requirements are set by the ASC and not by the *Corporations Law*.

The experience criterion may be viewed as an attempt objectively to assess what has sometimes been described as an individual's 'business acumen'. For instance, the ASC has stated that experience is the important element in registration and it has set very stringent and precise requirements relating to experience for both registered liquidators and official liquidators as a means of assuring that a person holds such skills. While this may simplify the assessment process and economise on the necessary resources, it also appears to be unduly restrictive by eliminating those with equivalent experience and ability obtained in other fields.

Effects on competition

The specific terms of the present criteria for registration, and the way in which they are applied in practice, ensures that the services of an insolvency practitioner will be available only from a narrowly defined pool of professionals. Entry to the market is effectively denied to people from other backgrounds who may be otherwise able to develop and market an expertise in the area.

It has been repeatedly submitted by the IPAA member of the Joint Working Party and the ASC that there is no barrier preventing someone, for example with legal qualifications, from being registered as an insolvency practitioner.[142] Nevertheless, there has been continuing concern that the ASC's present narrow criteria unnecessarily restrict those from a non-accountancy background.

Various interested parties, including the IPAA member of the Joint Working Party, submit that people outside accountancy, including company directors, merchant bankers, lawyers etc could offer skills equal to those of people with predominantly accounting qualifications and experience. The IPAA member of the Joint Working Party on insolvency acknowledged that there were a number of non-registered people in business generally who would be able to do

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[141] The use of private trustees in bankruptcy proceedings reflects a relatively recent change to the *Bankruptcy Act* in 1981 allowing private trustees, who have met the registration requirements under the Act, to be trustees in bankruptcy. Further information is on page 134 in Attachment 3.

[142] The ASC indicates that it is currently considering an application from a lawyer who meets the experience requirements. The IPAA for its part considers that proposed changes to its Rules and its introduction of a professional qualification for insolvency practitioners which is open to both lawyers and accountants, makes it more likely that lawyers will be registered as insolvency practitioners.

receiverships. Such people would be unable to meet the experience criterion as presently interpreted.

It has been argued that those who may have the ability to practice in insolvency, but who are currently excluded by the requirements, do not wish to practice in the field in any event. This argument, directed at the supply side of the market, suffers from the difficulty that the registration requirements send a clear signal to any who may develop the expertise not to attempt registration. It is of interest to note that applications are often rejected or withdrawn before consideration because the applicant does not satisfy the experience requirements.[143]

It is also necessary to note that the registration requirements further confine the ability to effectively compete in the market to a very small group of practitioners even within the group of registered liquidators. There are three registrations involved in insolvency with the following numbers of registrants:

registered liquidator	1044
official liquidator[144]	256
trustee in bankruptcy[145]	244

As noted above, registration as an official liquidator requires a longer period of experience in insolvency administration and official liquidators represent about 25% of registered liquidators. While registered liquidators form the larger group of practitioners, only official liquidators can receive appointments from the Courts (compulsory windings-up and provisional liquidations) and there is also additional standing associated with the title.

Submissions from the IPAA member of the Joint Working Party suggest that it may not be an advantage for a practitioner to be an official liquidator as the onerous duties of the position, such as having to bear the cost of assetless administrations, often outweigh any advantage that might come from the title. However, other submissions state that official liquidator status has significance even in those areas where it is not required and claim that the advantages outweigh the 'burdens'. Those submissions suggest that, without a person registered as an official liquidator a firm will, in practice, be severely impeded in its ability to establish a significant insolvency practice.[146]

It has been submitted that somewhere in the order of 70% of court appointments will impose a cost on the liquidator.[147] However, it should be noted that it has never been suggested that insolvency practitioners have low profits even with the 'burden' that they are obliged to bear.

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[143] Full statistics on the reasons have not been available but, by way of example, page 32 of the 1985-86 annual report of the NSW Corporate Affairs Commission indicates that, apart from withdrawals recorded for administrative reasons, the applicant's inability to meet the experience requirements represented a major reason for withdrawals.

[144] The figures for liquidators are as at 24 February 1992.

[145] as at 30 June 1991.

[146] Submissions specifically denied by the IPAA member of the Joint Working Party.

[147] Data indicating the precise number of court appointments for which the liquidator is not remunerated has been sought but is not available. Data on the relative costs of assetless administrations compared with the fees obtained from other appointments would assist in assessing the size of the burden borne by official liquidators.

Current statistics which reveal the proportion of insolvency administrations performed by firms which have an official liquidator have been sought but have not been available. However, comments in a speech delivered by a former member of the Company Auditors and Liquidators Disciplinary Board in Adelaide in 1984 suggest that the great bulk of insolvency work in Australia is performed by firms with official liquidators.[148] This information, agrees with the other information obtained.

While it is evident that an individual firm may operate in insolvency without an official liquidator, a number of factors appear to reinforce the significance of the title:

- the status of the title is important to the reputation of the firm;
- in those States where a rotation system is used for Court appointments, registration as an official liquidator will provide a floor of work in the practice from Court appointments;[149] and
- in those States where a rotation system is not used, referring solicitors usually require that the practitioner's firm will be able to undertake any administration referred to it whether it involves Court appointment or not.

The experience requirements, in particular that an applicant have *corporate insolvency* experience *under the direction of* or *under the direct supervision of* an official liquidator, appear to reinforce and perpetuate the narrow market. Accepting that most official liquidators come from the major accountancy firms or specialist insolvency firms, the present registration requirements would appear not only to prevent competition from outside the profession, but also to impede competition from outside the established insolvency firms.

As a result, a number of groups are presently excluded from registration who may be able to enter and provide comparable service if more flexible experience requirements applied, including:

- registered liquidators unable to obtain registration as official liquidators such as those who do not presently have the requisite experience to qualify as official liquidators;
- trustees in bankruptcy unable to be registered as liquidators;[150]
- lawyers already with experience in the legal side of insolvency administration; and
- those with broader commercial experience who may have particular skills relevant to specific administrations.[151]

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[148] The Annual lecture of the Australian Society of Accountants presented by Mr W J M Ewing on 26 September 1984 at the University of Adelaide, titled *Insolvency — Growth and Separatism*; extracts of which are on page 149 in Attachment 3.

[149] For many of these appointments the liquidator may not be remunerated for the administration as there are no assets available to cover the costs. As already noted, however, figures have not been available to indicate the extent to which the 'burden' of assetless administrations is outweighed by the more substantial administrations for which remuneration is available.

[150] Some submissions note that experience as a trustee in bankruptcy is not considered relevant for registration as a liquidator. The ASC's criteria for requisite experience confirm this with the requirement that the person have worked in a range of **corporate** insolvency administrations.

[151] That is not to say that any person with professional standing would be suitable for registration.

Public interest issues

There are three key arguments put in support of the present stringent requirements for registration.

1. **Market information problems.** It is argued that creditors wishing to participate actively in the insolvency process will often lack the expertise necessary to make an informed choice of practitioner. It is also suggested that the Courts would have difficulty assessing the expertise of nominated practitioners and would prefer to be able to assume it. However, not all users of insolvency services suffer from information problems, for example:

   — In receiverships the main players are usually large financial institutions who are sophisticated users of insolvency services well able to make informed decisions about the expertise and judgment of practitioners. It is difficult to conclude that market information problems in receiverships are so serious that they justify tight restrictions of choice of practitioners.

   — For liquidations and bankruptcies different considerations may apply where users, who are often unsecured creditors from a wide range of business and personal backgrounds, are likely to be less sophisticated. Although, among these users, particularly in those States where there is no rotation system, liquidators are usually appointed on the referral of a solicitor who is generally well informed about what criteria should be taken into account.[152]

   — For the Courts, administrative efficiencies can be obtained if they can process applications for appointment of practitioners speedily and without having to assess the individual applicant's skills on each occasion.

2. **Consequences of poor administrations (market externalities).** Secured creditors, unsecured creditors, directors, shareholders and employees may all have an interest in an insolvency administration. In some larger administrations the consequences can have wide implications for an entire industry and may also have an effect on the economy generally. Those same people who may be affected by the insolvency administration also often have little direct influence over the process or in the selection and supervision of the practitioner. The potential for substantial direct and indirect adverse consequences provides some justification for licensing rather than certification to regulate entry.[153]

3. **Professional independence and integrity.** Where the practitioner is established as trustee of the assets of the insolvent estate or company, particular care must be taken to ensure that the practitioner is worthy of that trust. However, even such a strict licensing system as presently exists will not in itself guarantee that this concern will be addressed. The protection of the public interest will largely depend on the commercial self-interest of the practitioner and the professional and ethical standards maintained and supervised by the profession and the various statutory and self-regulatory bodies. Similar safeguards could be incorporated in less stringent

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[152] The Commission has no figures on the extent to which appointments are by solicitor, but the information available to it suggests that most appointments are in fact made by solicitors who also prepare the necessary documentation and make the applications to the Court. ITSA has stated that appointments of trustees in bankruptcy are usually not done by solicitors but are often by ill-informed unsecured creditors.

[153] The IPAA member of the Joint Working Party notes that insolvency practitioners are subject to supervision by the ASC and ultimately the Courts.

licensing requirements. Thus, while this concern is an important public interest issue, it does not provide strong support on its own for the present stringent licensing approach because the public interest can be protected in other ways.

Analysis

Most submissions focus on the nature of the skills which must be held by the practitioner if the public interest is to be protected and suggest that the present stringent criteria for entry are appropriate and should not be changed to allow a wider pool of potential practitioners.

Others, however, query this and suggest that other experience provides sufficient basis for exercising the skills of an insolvency practitioner. Some submissions note that for the large majority of liquidations and bankruptcies accounting skills of a high order are not required with most tasks requiring a mixture of skill in negotiation (with creditors, debtors, employees and other interested parties, often in a hostile environment) and legal skills (to resolve such matters as preference claims, debtor disputes, and set-offs). They suggest also that there is no reason to assume that the blend of accounting, legal, and wider commercial skills necessary in insolvency administration, can be obtained only from within insolvency practice.

It is of course, necessary that the true financial position of the company or estate be established and, depending on the nature of a particular administration, this may require that significant accounting functions be performed. Yet the level of accounting skills required in many insolvency administrations does not appear to require the specific level of experience currently prescribed. Furthermore, where additional skills are required it is not clear that the skill to perform those functions must reside in the liquidator or trustee. Many necessary functions in an administration are presently not provided by the firm of the liquidator or trustee. These functions, particularly in larger administrations, are often contracted out to other service providers and the liquidator/trustee fulfils the role of central administrator overseeing the various tasks.[154]

The IPAA member of the Joint Working Party has strongly submitted that the skills to make the basic assessment of the business of a company must reside in the insolvency practitioner and that to make this assessment requires an understanding of financial and commercial matters. This may well be the case. However, it does not follow that these skills may only be developed within the experience base presently prescribed and neither is it clear that a practitioner's skill in this area could not be supplemented where necessary from external sources without undermining the reliability of the insolvency administration.

Of the public interest concerns that support a regulated approach to entry to the market, the potential consequences for third parties appear to be the strongest. The professional independence and integrity concerns are linked to the need to protect affected parties. It is not clear that market information problems are significant in receiverships and larger liquidations but in smaller liquidations and bankruptcies the concerns are greater. The use of referring solicitors and involvement of the Court alleviates to some extent the effects of any disparity in knowledge between users and practitioners.

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154 It is of interest to note that in the US , where there is more of an emphasis on the use of lawyers as the central administrator, it is accountants who are often given the contracts to perform necessary accounting tasks. Refer Professor Grant Newton *Bankruptcy & Insolvency Accounting Practice and Procedure, 4th ed* for a detailed discussion on the various areas in which an accountant is engaged in US Bankruptcy administration.

It is arguable that some form of regulated entry barrier is warranted to protect the public interest.[155] However, that does not necessarily lead to the conclusion that those concerns can be met only by licensing with the stringent entry criteria that presently exist. As noted above, self-regulatory and statutory supervision of practitioners can be used to maintain ethical and professional standards.

The absence of meaningful statistical information has hampered attempts to quantitatively assess the full effects of the present registration requirements in insolvency.[156] However, the information available does not support the present tight restrictions but rather suggests that many insolvency administrations could be effectively administered by those with alternative experience.

Of interest is the submission of the NSW Law Society proposing that a separate class of insolvency practitioner could administer insolvent small business corporations. The submission is not answered merely by suggesting that there is nothing to stop lawyers from being registered presently. The requirements are stringent, requiring very precisely defined experience and do not allow the flexibility to consider alternatives.

If it were possible to confine the requirements for specific skill and experience to those areas where the public interest requires them, then advantages could be gained in terms of efficiencies and cost savings.[157] It is not clear that it is necessary to draw the line at the present point and it appears rather that many windings-up, bankruptcies and smaller receiverships involve more in the way of legal and negotiating skills than they do accounting expertise.[158]

It is evident from the comments and submissions to this study that the role of an insolvency practitioner in Australia today is only indirectly linked to the accountancy profession.[159] The fact that some accounting skills (although often not necessarily of a high order) will be essential in any administration, does not necessarily justify confining registration to a narrow group of professionals.

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155 The past experience in the United Kingdom of unregistered practitioners is illustrative of the apparent justification for some licensing system. However, it is noteworthy that the relevant criteria for registration in the UK do not appear to be as stringent as those in Australia. New Zealand provides a contrast where there continues to be no licensing system.

156 It is hoped that one of the issues to be explored by the Attorney General's Department Working Group (referred to on page 74 below) will be the need to improve the collection of meaningful statistics to allow adequate monitoring and assessment of the effects of the regulatory regime.

157 This is already partly recognised in some States with procedures for registration of regional official liquidators who would normally not meet the stringent registration requirements but who are permitted to administer certain less complex liquidations.

158 The IPAA member of the Joint Working Party acknowledges that not all insolvency work is complex and categorisation of practitioners may be worthy of consideration. Although it believes that problems may arise when persons of less experience are confronted with the extraordinary and states that "such a development of a second class of insolvency practitioners must be strenuously opposed".

159 To use the words of the IPAA member of the Joint Working Party in its responses to the Draft Report:

> *The practice of insolvency is, however, one which involves the application of not only accountancy skills, but also those relating to business generally, decision-making, negotiation, application of appropriate legal principles, and general good judgment. It has been said by some practitioners that the insolvency section of the accountancy profession is, as it were, a profession in itself, requiring the application of [these] qualities.*

Conclusion & recommendation

The conclusion, on the available information, is that a licensing approach to insolvency management may assist in protecting third parties from the effects of inadequate administrations. It is not the only measure needed, however, and needs to be complemented by ethical and professional standards. Moreover, it is not clear that the existing restrictions on registration need to be as onerous as they are to achieve this objective, particularly as they appear to prevent entry to the profession by practitioners who could provide additional competition and therefore incentives for economy and efficiency among practitioners.

It is recommended that the present narrow entry requirements be broadened to reduce their present restrictions on the potential for competition from a wider pool of appropriately qualified practitioners. It is important to retain flexibility on where prescribed experience must be obtained and also on who might be competent to perform less complex administrations.

Specifically, consideration should be given to the following.

- Broadening the category of persons who can be registered as liquidators and official liquidators to allow experience gained as a trustee in bankruptcy or in other relevant fields of employment.

- The practical implications of a system of categories of registered practitioners, such as a liquidator of small business corporations, which goes further than the existing divisions to recognise the varying degrees of complexity involved in administrations. Such proposals should not be lightly dismissed on the grounds of the additional administrative burdens involved.

- Whether there is a continuing need for the current disparity in the treatment of personal and corporate insolvencies. The functions and public interest issues involved do not appear to be sufficiently different to require almost entirely separate regulatory regimes.[160]

- Methods of improving the statistical information available on insolvency practice.

The ASC emphasises that in establishing the relevant experience criteria it must bear in mind the objective of

- ensuring commercial certainty in the market place;

- being effective in administration but with a minimum of procedural requirements; and

- achieving uniformity throughout Australia.

These objectives, which may be summarised as a need to achieve efficiency in administering a national scheme, are clearly important in any system of registration. The query raised,

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[160] It was recommended in the Harmer Report that the administration of registration for both areas be combined.

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however, is whether those objectives may be achieved only with very stringent, and apparently deliberately inflexible, criteria. The high objective standard unquestionably assists ease of administration and certainty, but these are not the only relevant criteria.

Those standards should also have the purpose of meeting an identified public interest need to regulate the market while having the minimum effect on competition possible to meet that need.

In December 1991 it was announced by the Commonwealth Government that steps would be taken to implement aspects of the Harmer Report. Presently a Draft Bill is being considered to address many of the significant recommendations made in the Report as they relate to the wider insolvency field. The issues relating to registration of insolvency practitioners, about which the Harmer Report also made recommendations,[161] are to be considered by a Working Group to be set up by the Attorney General's Department.

The Commission supports this process as a further opportunity to explore the correct balance between the need to regulate in the public interest; the desire to minimise anti-competitive effects and the practical need to ensure efficiency in administration.

The IPAA scale of fees

As discussed in the section on conduct regulation, there is, generally speaking, no scale of fees operating in the wider accountancy markets.

It was also noted that a scale of fees has significant potential difficulty under the provisions of the *Trade Practices Act*[162] being likely to reduce price competition and even eliminate it altogether. This is especially so where compliance with the scale is effectively mandatory. Even where a scale is only recommended it may still carry an anti-competitive potential, for example, where it operates as a defacto standard complied with by all or most insolvency practitioners.[163]

A recommended scale of fees, promulgated by the IPAA,[164] operates in the insolvency market which may affect competitive pricing behaviour. The IPAA has in the past recommended that its scale of fees be applied by insolvency practitioners in establishing an appropriate fee for the service provided. It is a recommended scale only as is clearly stated on the attachments to the scale itself.[165]

In most cases the practitioner's remuneration is set by a meeting of creditors but for corporate insolvency the Courts maintain a supervisory role. The Courts in a number of States have

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161 Refer to the *Summary of some relevant portions of the Harmer Report* on page 141 in Attachment 3

162 page 34 above.

163 Even where a scale of fees promulgated by an industry or professional association is truly recommended and does not come within the terms of the prohibition on price fixing, it may still contravene the more general prohibition on anticompetitive arrangements that substantially lessen competition (section 45).

164 The IPAA first issued a recommended scale of fees effective from 1 July 1982. Prior to this the Bankruptcy Trustees' & Liquidators Association of Australia issued recommendations as a guide to members for the setting of fees to be charged in insolvency matters in June 1974, December 1977, March 1980 and July 1981.

165 A copy of the scale effective until December 1991 as well as a copy of the latest *Guide to hourly rates* effective from 1 December 1991 is on pages 151-155 in Attachment 3.