Chapter 1

Introduction

Background

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

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

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

The focus of the inquiry

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Conduct of the inquiry

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

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

Submissions

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

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

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

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

Public hearings

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

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

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

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

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

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

Acknowledgements

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

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

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

Past inquiries and reform

1.22 Australia's insolvency regime is not a new area of inquiry. In 1988, the Australian Law Reform Commission (ALRC) conducted a major review of Australia's

insolvency laws. The Harmer report, as it is known, was implemented by the *Corporate Law Reform Act 1992*.[13]

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

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

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

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

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

14 Section 435, *Corporations Act 2001*

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

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

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

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

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

Context of the inquiry

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

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

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

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

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

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

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

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

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

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

Key themes and the structure of the report

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

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

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

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23 ASIC, *Submission 69*, pp. 69–70.

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

1.35 Chapter 6 examines the adequacy of the regulatory framework. In particular, it looks at the evidence that ASIC and the CALDB have been unresponsive and ineffective in their oversight of the insolvency regime. It considers some of the reasons why this has been the case, including claims that the regulator is overburdened, unfocussed and inadequately resourced and that the disciplinary body has inadequate powers.

1.36 Chapter 7 is concerned with the registration of insolvency practitioners. It considers criticism that the process and standards for registering practitioners is inadequate and needs to be strengthened. There are three contexts to this criticism: that the profession recruits too narrowly; that it admits without adequate checks; and that it is too difficult to suspend or dismiss a liquidator once he or she is appointed.

1.37 Chapter 8 deals with the remuneration of insolvency practitioners. In this and in previous inquiries into the insolvency industry in Australia, the issues of the method, level and disclosure of practitioners' fees have been highly contentious. The chapter discusses these criticisms and concerns that practitioners have been able to inflate their fees through disbursement payments.

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

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