ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

27 January 2020

Ms Kate Carnell
Australian Small Business and Family Enterprise Ombudsman
GPO Box 1791
CANBERRA ACT 2601

By email: inquiries@asbfeo.gov.au

Dear Ms Carnell

Insolvency Practices Inquiry

Thank you for the opportunity to respond to the questions raised in the Insolvency Practices Inquiry Discussion Paper (Discussion Paper).

We believe that the ASBFEO Insolvency Practices Inquiry highlights and reinforces the need for ARITA's previously announced Financial Recovery Law Reform Commission, as detailed in ARITA's 8-point plan, to strengthen the insolvency regime.

Our response to the questions has been reached with consideration of the following key matters, which we have expanded on in our introductory comments:

- Need for comprehensive review of Australia's personal and corporate insolvency regimes
- The definition of a small business
- So-called "vanilla" external administrations
- Unregulated 'pre-insolvency advisors'

Having consulted with our broad membership, which includes around 85% of registered liquidators and trustees, we provide the following recommendations in response to the Discussion Paper:

- **Recommendation 1:** ARITA supports the provision of a plain language fact sheet outlining the various types of external administration and the role of directors and owners in each. ARITA commenced work on these guides some months ago and is currently seeking financial support from the Federal Government to expedite the project.

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While we acknowledge the benefits of providing written reasons for recommending a particular course of action to the directors, we understand that the provision of written advice may be seen as an increased risk for professional indemnity insurers. As a result, some practitioners may charge for initial consultations if written advice is required, which are generally currently provided for no charge.

- **Recommendation 2:** The existing law requires that remuneration and disbursements of an external administrator should be “necessary and proper”. When seeking approval for remuneration, sufficient information must be provided to allow creditors to make an informed assessment.

- **Recommendation 3:** ARITA believes that too many variables exist to be able to accurately provide creditors with an information sheet of the average costs for a ‘day in court’ and the average numbers of court days for particular actions in a manner which would be sufficiently certain and useful.

- **Recommendation 4:** ARITA continues to advocate that open access, free of charge, to data held in government business registers provides the greatest benefits to the business community and the broader Australian economy. We believe that this access would be more beneficial than the automatic provision of Annual Administration Return reports to creditors, directors and owners.

- **Recommendation 5:** ARITA is strongly of the opinion that any requirement to disclose valuations and/or specific marketing strategies would severely undermine the integrity of the sale process.

- **Recommendation 6:** ARITA agrees that some level of the evidence relied on should be provided by registered liquidators when issuing demands for the recovery of unfair preferences.

- **Recommendation 7:** ARITA believes directors should be required to undertake basic education which enables them to adequately understand the duties and responsibilities of their position, and good corporate and financial judgment requirements.

- **Recommendation 8:** ARITA believes individuals should be required to undertake basic education which enables them to adequately understand the duties and responsibilities of running a business; and good corporate and financial judgment requirements.

- **Recommendation 9:** ARITA supports the provision of a plain language fact sheet outlining the various types of external administration and the role of directors and owners in each. ARITA commenced work on these guides some months ago and is currently seeking financial support from the Federal Government to expedite the project.

While we acknowledge the benefits of providing written reasons for recommending a particular course of action to the directors, we understand that the provision of written advice may be seen as an increased risk for professional indemnity insurers. As a result, some practitioners may charge for initial consultations if written advice is required, which are generally currently provided for no charge.

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- **Recommendation 10:** The existing safe harbour provisions provide a valuable tool to enable small businesses to take action early and gain time to assess the viability of the business. Rather than amending the provisions, more education is required to ensure small business owners seek the advice of an appropriately qualified advisor early to take advantage of this mechanism.

- **Recommendation 11:** Accountants and bookkeepers who are not experts in financial distress should refer their clients to a subject matter expert.

- **Recommendation 12:** ARITA agrees with the need for increased funding and resources to enable the provision of insolvency training to financial counsellors and, arising from the Sylvan Report, has approached the Federal Government to provide this.

- **Recommendation 13:** Mental health should receive the same recognition as any other health concern; however, as with any other illness, it should not be a basis for interrupting a small business' legal obligations to its creditors.

- **Recommendation 14:** Specific resources are needed to assist parties dealing with mental health issues and ARITA is already actively engaging with Beyond Blue to develop resources to support small business owners with their mental health and the challenges they face. The aim is for these resources to be immediately provided to those caught up in an insolvency.

- **Recommendation 15:** ARITA continues to support the consideration of a streamlined liquidation process for MSME companies and pre-positioned sales but agrees with past recommendations which do not support pre-pack or Chapter 11 regimes.

Please contact me (jwinter@arita.com.au or 02 8004 4355) or ARITA's Technical & Standards Director, Narelle Ferrier (nferrier@arita.com.au or 02 8004 4350) if you wish to discuss these matters further.

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents professionals who specialise in the fields of restructuring, insolvency and turnaround.

We have more than 2,300 members and subscribers including accountants, lawyers and other professionals with an interest in insolvency and restructuring.

Some 82% of Registered Liquidators and 87% of Registered Trustees choose to be ARITA members.

ARITA's ambition is to lead and support appropriate and efficient means to expertly manage financial recovery.

We achieve this by providing innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large. In 2018, ARITA delivered 183 professional development sessions to nearly 6,000 attendees.

ARITA promotes best practice and provides a forum for debate on key issues facing the profession.

We also engage in thought leadership and public policy advocacy underpinned by our members' needs, knowledge and experience. We represented the profession at over 20 inquiries, hearings and public policy consultations during 2018.

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Introductory comments

Need for comprehensive review of Australia’s personal and corporate

The last comprehensive and focused review of Australia’s insolvency laws – the Harmer Report – was launched in 1983 and delivered in 1988. This was a time of bricks and mortar businesses compared to the service-based economy and virtual marketplace that exists now.

As it stands, Australia’s insolvency law is amongst the most complex and voluminous in the world. It’s fair to say that only our tax laws are more complex. Also, the separation of Australia’s personal and corporate insolvency systems is poorly understood, even by many policymakers.

Existing insolvency laws also do not support micro and small to medium business insolvencies.

This not only puts us out of step with global best practice but also, in effect makes our system unresponsive to 97% of Australia’s businesses. Additionally, our laws fail to grapple with the heavy overlap of small business insolvencies and any associated personal bankruptcy for the directors of those businesses. This adds a further significant burden for small business operators in financial distress as they have to navigate through two different insolvency regimes.

ARITA believes now is the time for a comprehensive review of Australia’s insolvency system.

There is an overwhelming need to set some clear and obvious principles that all insolvency law reform must follow. Our insolvency laws must be:

> **SIMPLE** – how do we justify having so much disjointed legislation rather than a single ‘Insolvency Act’ – as the UK has had for the past 30 years?
>
> **EFFICIENT** – complexity comes at a cost. We need a system that delivers value to creditors and facilitates efficiency for insolvency professionals.
>
> **EFFECTIVE** – substantial failings in the first two principles – simple and efficient – undermine insolvency practitioners’ ability to deliver effective outcomes for insolvency stakeholders.

ARITA is prepared to lead and drive this. We have announced that we will be creating a Financial Recovery Law Reform Commission which will be led by eminent commissioners and will aim to create a template for reform that will deliver a world’s best practice system. While, as a profession, we will primarily fund this important endeavour, we will be seeking the support of government to assist in properly resourcing it.

The matters raised in your Discussion Paper reinforce the need for this wholesale review.

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Definition of small business

Our responses to the questions detailed in the Discussion Paper are made with reference to the definition of small business as detailed in the *Australian Small Business and Family Enterprise Ombudsman Act 2015.*

Meaning of small business

(1) A business is a small business at a particular time in a financial year (the current year) if:
   (a) it has fewer than 100 employees at that time; or
   (b) either:
      (i) its revenue for the previous financial year is $5,000,000 or less; or
      (ii) if there was no time in the previous financial year when the business was carried on—its revenue for the current year is $5,000,000 or less.

(2) For the purposes of this section, business includes an enterprise, activity, project, undertaking or arrangement.

(3) In counting employees for the purposes of the definition of small business in subsection (1), take part-time employees into account as an appropriate fraction of a full-time equivalent.

(4) Revenue is to be calculated for the purposes of this section in accordance with accounting standards in force at the relevant time.

While data is not maintained regarding historical revenue for companies in external administration, data available from ASIC indicates that in 2018-2019 at least 76.5% of reports lodged related to companies with less than 20 employees.[1]

This clearly shows that the vast majority of external administrations in Australia are small businesses and that, therefore, concerns about how the insolvency regime addresses small business are, in fact, concerns about almost the entire operation of the regime.

Vanilla external administrations

The Discussion Paper refers to the cost to complete a ‘vanilla’ voluntary administration (page 12).

Given the unique nature of insolvency appointments, ARITA does not believe that a ‘vanilla’ voluntary administration (or other insolvent external administration) exists. While practitioners may estimate the cost of a voluntary administration, the actual costs may vary significantly depending on the circumstances, including, but not limited to:

- The type of external administration appointment, with the investigation and reporting obligations in a voluntary administration adding significant costs to the process

[1] ASIC Report 645: Insolvency statistics: External administrators’ reports (July 2018 to June 2019), December 2019

- Whether the appointment involves a trust structure (noting that trusts, generally recommended by accountants and lawyers for their tax and asset protection benefits, are now widespread in SMEs)
- Any prior involvement of a dodgy pre-insolvency advisor/phoenix facilitator
- The nature of any transactions undertaken prior to appointment to distance assets or pay particular creditors (usually for the benefit of directors with personal guarantees)
- The level of co-operation from the company directors and senior management staff and whether there are any ongoing disputes between them
- Whether the business continues to trade
- The existence and access to adequate books and records
- The existence of realisable assets
- Availability of assets to fund investigations and/or recovery actions, including increasing obligations to conduct comprehensive investigations even where funding may not be available
- Drawn out legal proceedings, including those commenced prior to the appointment which may be continued with the leave of the Court
- Extensive statutory requirements associated with the distribution of any available funds to creditors.

Arguably, only solvent “members voluntary liquidations” (MVLs), with no assets or liabilities, can be considered ‘vanilla’ and these types of appointments are often charged for on a fixed cost basis. Solvent liquidations do not have investigation requirements and can generally be undertaken by unregistered liquidators when it is a liquidation of a small proprietary company. On our research, the minimum cost of the most basic MVLs is still of the order of $5,000-$10,000 in an open, competitive and unregulated market (generally provided by accountants or lawyers in public practice). This is despite an absence of many compliance costs, including additional overheads imposed on registered liquidators by the ASIC Industry Funding Levy.

It is also important to note that the regulators and courts have made it clear to the insolvency profession that they take a dim view of a “vanilla” approach being taken to any insolvency in so far as it implies that less than full diligence was given to all aspects of the appointment, especially in regard to investigations and reporting.

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Unregulated ‘pre-insolvency advisors’

Insolvency practitioners are becoming increasingly concerned about the rise of the largely unregulated ‘pre-insolvency’ advice market.

Not to be confused with qualified professionals giving lawful advice, these ‘pre-insolvency advisors’ counsel their clients, often small business operators, on how to move assets and avoid paying their debts and meeting their legal obligations.

They are ambulance chasers who prey on people and businesses in financial distress. They claim to be able to remove the worry of a dire financial situation, but they often encourage unlawful conduct such as hiding or stripping assets and illegal phoenixing.

These pre-insolvency advisors are not Registered Liquidators or Trustees. They are not lawyers or tax practitioners and do not hold Australian Financial Services Licenses. This means they are totally unlicensed and operate without scrutiny from any regulator.

The lack of regulation also means that there is no accountability and no recourse. They are generally not members of any professional bodies; hold no professional registrations and therefore do not have any indemnity insurance should things go awry.

These unlicensed pre-insolvency advisors all exploit one thing: they know that the regulators are unlikely to chase them. While a 2015 ARITA survey found that 78% of liquidators had encountered liquidations where the company had seen a pre-insolvency advisor, there have been few prosecutions to date.

Effective enforcement action is needed to shut down these dodgy advisors. ARITA believes the advice being offered by pre-insolvency advisors should be considered corporate or personal insolvency advice. Therefore, pre-insolvency advisors should be licensed and subject to the same legal duties as insolvency practitioners or lawyers.

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Small business experience

Loss of Control

1. At the initial consultation with a registered liquidator, should the registered liquidator be required to provide a small business with:

a. a hard copy plain language fact sheet that outlines the various types of external administration and the role of directors and owners in each?

b. the reasons for recommending a particular course of action to the directors?

Recommendation 1: ARITA supports the provision of a plain language fact sheet outlining the various types of external administration and the role of directors and owners in each. ARITA commenced work on these guides some months ago and is currently seeking financial support from the Federal Government to expedite the project.

While we acknowledge the benefits of providing written reasons for recommending a particular course of action to the directors, we understand that the provision of written advice may be seen as an increased risk for professional indemnity insurers. As a result some practitioners may charge for initial consultations if written advice is required, which are generally currently provided for no charge.

Insolvencies are complex and can be difficult to navigate for everyone involved.

Yet there is a lack of simple and up to date, plain English guides for these groups:

- Company directors – who need to better understand how insolvencies work and the importance of seeking advice as early as possible when faced with financial difficulty. The earlier a business seeks advice, the more likely it will be saved.
- Creditors & employees – also need to understand how insolvency works and how they can recover the money they're owed.
- People with unmanageable debt – need to understand what debt relief is available, what their options are and whether bankruptcy is suitable for their situation.

At the moment, the information that is available from various government websites is, with some exceptions (such as some provided by AFSA) confusing and complex. There are no financial literacy initiatives targeting how to manage financial distress, leaving individuals and small businesses at genuine risk.

ARITA is producing a range of plain English guides, for which we have sought financial support from the Federal Government to expedite completion, but government needs to do much more in this space, including additional financial literacy initiatives and funding increased support to financial counsellors and their training, helping to stave off dodgy pre-insolvency advisors.

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Costs

2. Should there be a control mechanism to prevent the total costs of an external administration from consuming the value of the company's assets? What form could this take?

Recommendation 2: The existing law requires that remuneration and disbursements of an external administrator should be "necessary and proper". When seeking approval for remuneration, sufficient information must be provided to allow creditors to make an informed assessment.

As noted in the Discussion Paper, since 2004 over half of the insolvencies reported by ASIC had total estimated assets of less than $50,000.

Consistent with the figure reported in the Discussion Paper for 2017-2018, ASIC's Report 645: Insolvency statistics: External administrators' reports (July 2018 – June 2019) notes that 78.3% of reports lodged indicated companies had estimated assets of $50,000 or less, with 36.8% of reports indicating companies were assetless.

A liquidator's work for an external administration appointment is paid for out of the money left in the insolvent company. The law also requires liquidators to do certain tasks on behalf of ASIC, including investigate the history of the company and investigate and report on possible misconduct by company directors regardless of whether there are funds available to be paid.

We do not believe that there should be a control mechanism which limits an external administrator's costs to prevent the consumption of the value of the company's assets for a number of reasons, including but not limited to:

1. The extensive mechanisms which already exist in the *Corporations Act 2001* (Cth) (Act) and ARITA Code of Professional Practice to ensure the parties approving remuneration and costs can make an informed decision on whether the amount sought is necessary and proper. This includes extensive amendments through the *Insolvency Law Reform Act* 2016 (Cth) (ILRA) giving creditors much greater power and access to information than previously.

2. As noted above, most liquidations have little to no assets before the cost of the liquidation. Simply put, if there isn't enough money left in the company to pay for the liquidator's work, they don't get paid (or not in full).

   Research by ARITA in 2017 indicated that liquidators do $100 million of unpaid work each year[2]. That works out to over $150,000 per liquidator. Shockingly, that's more than many liquidators earn, especially those who service small-to-medium businesses.

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[2] ARITA "State of the Profession" survey 2017.

3. It is unreasonable to expect a highly qualified professional, who also assumes a high level of personal financial risk, to undertake professional services for nothing or very limited amounts. Noting that many liquidators already do this notwithstanding that there is no requirement to accept these appointments, further restrictions on remuneration are unreasonable.

Careful consideration of the basis of charging remuneration was considered by the New South Wales Court of Appeal in *Sanderson as Liquidator of Sakr Nominees Pty Ltd (in liquidation) v Sakr* [2017] NSWCA 38.

The judgment is a landmark decision providing significant and comprehensive judicial discussion and statement of principles relating to the determination of liquidator remuneration, including the concept of 'proportionality' and provided clarity and certainty regarding the proper consideration of the factors in s 473(10) of the Act.

These same factors are essentially reproduced in s 60-12 of the new Insolvency Practice Schedule (Corporations) (new Schedule 2 to the Act), operational from 1 September 2017.

A copy of ARITA's summary of the decision in included at Appendix A for your ease of reference.

3. Should an information sheet of the average costs for a 'day in court' and the average numbers of court days for particular actions, be included with each creditors report?

Recommendation 3: ARITA believes that too many variables exist to be able to accurately provide creditors with an information sheet of the average costs for a 'day in court' and the average numbers of court days for particular actions in a manner which would be sufficiently certain and useful.

While general information may be included in reports to creditors (at the discretion of the relevant external administrator) concerning the need for Court hearings and the consequential costs this may involve, ARITA is concerned that to mandate the provision of an information sheet may be counter-productive.

The estimation of 'average costs for a day in court' is subject to a significant number of variables. The costs of a 'day in court' will differ depending on the:

- jurisdiction of the Court (Federal Court or State based Court)
- level of Court (local, district, supreme) as this will impact the Court filing fees payable
- size and complexity of the matter (for e.g., number of witnesses, cross examination of witnesses, use of technology in Court etc.)
- number of lawyers and/or barristers involved
- preparation time for hearing day/s

- the degree of dispute that exists between parties and their willingness to resolve any such dispute, and

- the actions, inactions and reactions of the other party, including but not limited to number of interlocutory applications, use of mediation whether court ordered or voluntary, the number of witnesses and experts for each side, whether parties are self represented and the potential for appeals.

The determination of the legal costs and fees associated with a dispute are usually considered and assessed by specialist lawyers (or cost assessors) under the relevant Court or State based legal profession legislation and regulations.

These systems detail a process where an independent but legally qualified costs assessor reviews and quantifies amounts payable under costs orders made by courts and tribunals, and determines fair and reasonable costs between clients and their lawyers in light of any costs agreements and relevant requirements of legal profession legislation. A similar system applies in the Federal Court where legal costs are assessed by reference to a set 'scale' of costs allowable for work done and services performed.

There are materials publicly available through the various courts which provide information and context concerning court fees and legal costs.[3] We consider that this type of information is more appropriate to educate the community as the average costs of a day in court rather than imposing a further obligation on registered liquidators acting in an external administration appointment.

It is also highlighted that, under the requirements of the Act, there are a number of Court applications which an external administrator may be required to make for Court approval of certain actions or conduct, and while such applications involve Court related costs these are often a necessary part of the conduct of a formal external administration.

4. In consideration of technology available today, how beneficial would it be to automatically provide the Annual Administration Return report lodged with ASIC to creditors, directors, owners?

Recommendation 4: ARITA continues to advocate that open access, free of charge, to data held in government business registers provides the greatest benefits to the business community and the broader Australian economy. We believe that this access would be more beneficial than the automatic provision of Annual Administration Return reports to creditors, directors and owners.

ARITA's strong position is that open access, free of charge, to data held in government business registers provides the greatest benefits to the business community and the broader Australian economy. Free access is also more aligned with the stated statutory objectives of

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[3] For e.g., the Federal Court website provides information on Court fees and legal costs (including an indicative schedule of barrister's fees) at https://www.fedcourt.gov.au/forms-and-fees

ASIC, particularly as they relate to promoting “confident and informed participation of investors and consumers in the financial system.”

A submission made by ARITA to the Productivity Commission details some of the benefits of free access. These arguments on the importance of open and free access to business data information were also stressed by ARITA in a number of other submissions made to The Treasury on its Modernising Business Registers program.[4].

Free use recognises that a fundamental assumption in economic theory to create “perfect” markets is free and open access to information for participants. Placing obstacles in the way to this free and open access necessarily leads to market inefficiencies and failures. Costs also disproportionally harm those in small business who are less likely to be able to absorb search costs or to employ expensive third-party, for-profit data providers.

It is also noted that both the United Kingdom and New Zealand provide for free access to company and business data held in their government-based registries.

As we understand it, the Annual Administration Return report may be lodged with ASIC in a structured data format which would not be in a format easily distributed to creditors. In order to provide the report in the format available from ASIC, liquidators, like creditors, directors and owners, would need to pay to access it from the ASIC website.

It is also noted that the ILRA specifically removed the requirement for liquidators to provide creditors with annual reporting and replaced it with the obligation to lodge the annual administration return.

The ILRA also provides creditors with specific powers to request information from the liquidator, which would include the provision of the information included in the annual administration return.

[4] For e.g. ARITA submission to the Treasury on Modernising Business Registers in August 2018.

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Lack of transparency

5. Should valuations be provided to, and proposed marketing strategies require approval from, creditors?

Recommendation 5: ARITA is strongly of the opinion that any requirement to disclose valuations and/or specific marketing strategies would severely undermine the integrity of the sale process.

External administrators have a positive obligation to achieve market value for the assets they realise. Disclosure of valuations and/or specific marketing strategies would critically undermine the integrity of this process.

It is essential to note, particularly in SME insolvencies, that often the only parties interested in acquiring the assets of the administration are related parties and/or creditors in the administration. The provision of valuations and marketing strategies in those circumstances in particular would be obviously prejudicial and destructive to achieving the obligation of achieving a maximum return for creditors.

In our experience external administrators provide creditors with an overview of their sale strategy when reporting, however specific information regarding interested parties and values are withheld for obvious commercial reasons.

6. Should demands to recover payments determined to give a creditor an unfair preference in a winding up require the registered liquidator to include the evidence they relied on in making that determination?

Recommendation 6: ARITA agrees that some level of the evidence relied on should be provided by registered liquidators when issuing demands for the recovery of unfair preferences.

While we believe it is reasonable to provide evidence regarding the insolvency of the company and the basis for making the demand, we would also suggest that creditors in receipt of such demands should seek timely legal advice regarding their options.

Education of directors

7. Should it be mandatory for individuals seeking to be directors of companies to undertake core education on running a business and the potential risks of personal exposure before being eligible for appointment?

Recommendation 7: ARITA believes directors should be required to undertake basic education which enables them to adequately understand the duties and responsibilities of their position, and good corporate and financial judgment requirements.

The skills and abilities of directors cover a wide spectrum. There is a need to ensure that all directors adequately understand the duties and responsibilities of their position, and the good corporate and financial judgment requirements

We recommend that the successful completion of a suitably structured "new director" course be required as a pre-requisite to the issuing of a Director Identity Number. Such a course could be similar to the driver knowledge tests which are required to be completed before obtaining a driver license. This could be endorsed by ASIC and offered as a short online course. We do not propose anything of the complexity or cost of, for e.g., the excellent and comprehensive Australian Institute of Company Directors or Governance Institute courses, but rather an introductory overview that could be completed in a matter of hours.

8. Should it be mandatory for individuals seeking to start a company or register an ABN to undertake core education on running a business and the potential risks of personal exposure to business?

Recommendation 8: ARITA believes individuals should be required to undertake basic education which enables them to adequately understand the duties and responsibilities of running a business; and good corporate and financial judgment requirements.

For the same reasons as noted at 7. above, we support mandatory core education for individuals seeking to start a company or register an ABN.

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Turnaround options

9. Where a small business seeks advice when facing financial difficulties, should the individual proposing a course of action be required to provide the small business with:

- a hard copy plain language fact sheet that outlines the various types of external administration available and the role of directors and owners in each?
- the reasons for recommending a particular course of action to the directors?

Recommendation 9: ARITA supports the provision of a plain language fact sheet outlining the various types of external administration and the role of directors and owners in each. ARITA commenced work on these guides some months ago and is currently seeking financial support from the Federal Government to expedite the project.

While we acknowledge the benefits of providing written reasons for recommending a particular course of action to the directors, we understand that the provision of written advice may be seen as an increased risk for professional indemnity insurers. As a result some practitioners may charge for initial consultations if written advice is required, which are generally currently provided for no charge.

As noted at 1 above, ARITA is producing a range of plain English guides. Again, we note that we are seeking Federal Government financial assistance to complete these in a timely fashion.

10. How can the safe harbour provision be improved to encourage small businesses to take action early and gain time to assess the viability of the business?

Recommendation 10: The existing safe harbour provisions provide a valuable tool to enable small businesses to take action early and gain time to assess the viability of the business. Rather than amending the provisions, more education is required to ensure small business owners seek the advice of an appropriately qualified advisor early to take advantage of this mechanism.

A small business is unlikely to have any knowledge of the safe harbour provisions unless they seek specialist insolvency advice. If a small business does not meet the eligibility criteria for the safe harbour defence then it is likely that the advice has already been sought too late.

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We believe that the current safe harbour provisions can apply to small businesses, with a number of appropriately qualified advisors, primarily ARITA Professional members, providing this advice to small businesses.

In this regard, we have consistently advocated that the provisions should be amended to stipulate that only Registered Liquidators, or a newly created sub-set of Registered Liquidators, are considered appropriately qualified 'safe harbour' advisors.

We would also note that ARITA Professional members are required to comply with the ARITA Code of Professional Practice when completing such engagements and may be subject to ARITA's disciplinary processes should they not comply with these obligations.

We are cognisant of the fact that many small businesses are unable to obtain the safe harbour protection as they do not meet the eligibility criteria, particularly the requirement to be up to date on the employee entitlements, including superannuation, and tax reporting obligations.

Historically it was common for businesses in financial distress to not report obligations to the ATO and not pay superannuation. Superannuation was considered an easy obligation to defer due to the lack of transparency and the fact that employees would rarely monitor its payment. However, it is anticipated that the implementation of single touch payroll obligations will help overcome this hurdle due to changed reporting obligations and greater transparency around payment (or non-payment) of superannuation.

Ensuring accountants, bookkeepers and financial counsellors are able to direct small businesses in financial distress to an appropriately qualified advisor early in the process, as noted at sections 11. and 12. below, would provide a greater benefit than a change in provisions.

We also note that the safe harbour provisions are subject to an independent review after two years of operation. This review is now past due.

11. How can accountants and bookkeepers best support small businesses to seek help early?

Recommendation 11: Accountants and bookkeepers who are not experts in financial distress should refer their clients to a subject matter expert.

Accountants and bookkeepers who have identified clients in financial distress but do not have training or expertise in insolvency related matters should not provide advice on insolvency options to their clients. Australian insolvency law is simply too complex for individuals without comprehensive training and expertise to be advising on. They should refer these clients to subject matter experts (such as ARITA Professional members) for specific advice regarding their options.

ARITA Professional members will generally not charge for an initial meeting to discuss the financial situation of a company or individual, and alternative courses of actions available to them.

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12. Should increased funding and resources be provided to the financial counselling sector to enable them to provide services to small businesses experiencing financial difficulty?

Recommendation 12: ARITA agrees with the need for increased funding and resources to enable the provision of insolvency training to financial counsellors and, arising from the Sylvan Report, has approached the Federal Government to provide this.

ARITA is acutely aware of the how important it is for the financial counselling sector to be well positioned to support Australians in need of financial advice and advocacy.

We support the recommendation of the Sylvan Review,[5] concerning the co-ordination and funding of financial counselling services, which stated that:

> "The Commonwealth, in consultation with small business bodies and the Small Business and Family Enterprise Ombudsman, continue the exploration of small business needs for financial counselling and the best methods to address the identified needs for subject matter expert advice."

As noted in the report, this expert advice extends to "explaining options and consequences of processes such as … bankruptcy".

Australia's bankruptcy laws, including corporate insolvency laws where micro-small businesses are involved, are highly complex and require specific training to understand, particularly given wide-ranging and highly technical changes that came into effect in 2017.

Financial counsellors are not subject matter experts in this area and do not receive proper training in insolvency to adequately support those seeking their services. Such training should be provided by a qualified insolvency specialist. We are in discussions with the Federal Government around these issues.

[5] The Countervailing Power: Review of the coordination and funding for financial counselling services across Australia, March 2019

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Mental health

13. Should the impact on the mental health of small business owners and directors be cause for a pause in proceedings?

Recommendation 13: Mental health should receive the same recognition as any other health concern; however, as with any other illness, it should not be a basis for interrupting a small business' legal obligations to its creditors.

ARITA recognises the impact financial stress can have on a person's mental health and has worked with AFSA and ASIC to create a program to educate insolvency professionals on the connection between insolvency and mental health and how they can better engage with people experiencing financial distress.[6] A significant number of insolvency professionals have now completed this course which is offered via Mental Health First Aid and their accredited trainers.

The training assists practitioners in providing support to those going through a challenging time but also ensure mental health issues are positively managed, with better outcomes for all.

Any pause in proceedings would have significant flow on effects and may cause financial issues for other small businesses or individuals who would be impacted by being unable to recover amounts owed to them.

The Act already provides protections from personal liability where a director was unable to take part in the management of a company because of illness or other good reason[7].

14. Are there other changes that could assist the parties where there are mental health issues?

Recommendation 14: Specific resources are needed to assist parties dealing with mental health issues and ARITA is already actively engaging with Beyond Blue to develop resources to support small business owners with their mental health and the challenges they face. The aim is for these resources to be immediately provided to those caught up in an insolvency.

It is envisaged that these resources would assist and support both owners of small businesses suffering financial distress and practitioners from small firms in dealing with their own mental health concerns; but would also be made available to all stakeholders in external administrations.

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[6] The "Insolvency Mental Health Awareness Program was co-developed by AFSA, ASIC and ARITA and rolled out in 2019. Further information is available at https://www.arita.com.au/ARITA/News/ARITA_News/Mental_health_training_programs_launched_for_insolvency_professionals.aspx

[7] Sections 588H(4) and 588X(4) Corporations Act 2001

This provides support to small business owners and operators, as well as those who may be impacted by the failure of, and possible non-payment, of the business.

These resources will clearly set out where appropriate qualified help can be sought to help them through their challenges.

One size fits all

15. General submissions are sought on the fairness of having one system and the benefits and risks of implementing different processes, so the costs and time to complete an external administration achieves the optimum outcome for creditors, employees and the company.

Recommendation 15: ARITA continues to support the consideration of a streamlined liquidation processes for MSME companies and pre-positioned sales but agrees with past recommendations which do not support pre-pack or Chapter 11 regimes.

Short form process for companies under a threshold - Streamlined liquidation

The current requirements of Australia's liquidation processes impose a number of statutory reporting and process obligations on liquidators, which have the effect of increasing the costs of the liquidation and reducing, or eliminating, the return to creditors.

We have previously proposed[8] that, where a company meets the micro company criteria (i.e. liabilities to unrelated entities less than $250,000) a new streamlined liquidation process automatically apply.

ARITA's streamlined liquidation process was supported by the Productivity Commission's Report into Business set-up, transfer and closure which specifically addressed the ASBFEO's question of whether one size fits all and made the following recommendation:

> **"RECOMMENDATION 15.1**
>
> The *Corporations Act 2001* (Cth) should be amended to provide for a simplified 'small liquidation' process.
>
> - This would only be available for those companies with liabilities to unrelated parties of less than $250 000.
> - To access small liquidations, directors should be required to lodge a petition to the Australian Securities and Investments Commission (ASIC) and verify that their books and records are accurate.
> - The primary role of the liquidator would be to ascertain the funds available to a reasonable extent, given a reduced timeframe. Requirements for meetings, reporting and investigations should be reduced accordingly.
> - The pursuit of unfair preference claims should be limited to those within three months of insolvency and of material amounts. The duty to pursue unfair

[8] ARITA's 'A Platform for Recovery 2014' policy position paper, available at https://www.arita.com.au/ARITA/About_Us/Public_policy_advocacy/ARITA/About_Us/public-policy-advocacy.aspx?hkey=903b5cb6-bcbe-4885-bac5-6eba190fb8ac

preferences should be explicitly removed unless there is a clear net benefit and it will not impede conclusion of the liquidation.

- Creditors would be able to opt out of the process and into a standard creditors' voluntary liquidation, and ASIC would be able to initiate further investigation if it has concerns of illegality.

Liquidators for these processes would be drawn from a panel of providers selected by tender to ASIC. Panel membership would be for a period of up to five years, with ASIC able to conduct tenders at regular intervals to ensure that demand can be met.

ASIC should be empowered to hear complaints of practitioner misconduct and if the complaint is upheld, replace the liquidator. ASIC should be enabled to take disciplinary action, if warranted, against the discharged liquidator, including the suspension from participation in the panel or revocation of their registration."

The Commission also considered that "ARITA's model should be amended to include the scope for ASIC to intervene to convert a streamlined process into a full liquidation. However, where it does so, ASIC should then fund the liquidation process through its Assetless Administration Fund. This should ensure that creditors who would prefer an expedited process are not unduly disadvantaged by enforcement actions, and that practitioners are appropriately remunerated in a manner proportionate to the level of service provision."

Short form process for companies under a threshold – micro restructuring

Section 185C of the *Bankruptcy Act 1966* provides a mechanism for individual debtors who meet specific eligibility criteria to enter a binding agreement with their creditors to accept a sum of money that the debtor can afford, more commonly referred to as a Part IX Debt Agreement.

In our 'A Platform for Recovery 2014' policy position paper, we proposed that a similar mechanism be implemented to deal with micro companies. It is envisaged that this process would be more streamlined and cost effective than the compromise alternatives that are available under the existing Voluntary Administration/Deed of Company Arrangement provisions of the Act.

Eligibility criteria to undertake a micro restructuring agreement would include:

- must meet the definition requirements for a micro company
- company must be insolvent, and
- not available to companies who, or companies whose directors, have previously done a micro restructuring agreement.

Although we do not propose to go into operational detail in this paper, we would recommend that any micro restructuring mechanism would require:

- The company to prepare a 'Report on company activities and property' (ROCAP) to be provided with the proposal. A Registered Liquidator to oversee the development and implementation of the proposal, possibly referred to as a Restructuring Monitor:
  - who examines and approves the proposal
  - issues the proposal to creditors, and
  - may set fixed or other fee basis for creditor consideration and approval at same time as proposal.
- Creditors vote to accept or to put the company into liquidation:
  - no need for physical meeting, with resolution able to be considered by circulation
  - if they vote for liquidation then the company proceeds to liquidation immediately
  - related parties cannot vote, and
  - if debt is purchased then purchase only entitled to vote for amount for which debt purchased.
- An accepted proposal would be put into effect by the Liquidator/Restructuring Monitor and would be subject to the following provisions:
  - no requirement to call or hold further meetings
  - if debts to unrelated entities exceed $250,000 then appointment would automatically convert to a Voluntary Administration with full investigation and reporting requirements (if directors wish to continue to put a Deed of Company Arrangement proposal to creditors), or creditors voluntary liquidation (if there is no Deed of Company Arrangement proposal)
  - streamlined proofs of debt process for debts under $10,000
  - no tax clearance from Australian Taxation Office required where dividend is less than $25,000 (10% of maximum liability amount) or 10 cents in the dollar, and
  - a default longer than 6 months automatically results in the company being placed into liquidation.
- Creditors may apply set aside the proposal if there is a lack of full disclosure in the proposal or injustice provisions, similar to the current requirements in a Part IX Debt Agreement.

Pre-packs

Pre-packs involve the arrangement of a sale of all or part of a company's undertaking before formal insolvency is entered, with the sale to be executed at or soon after the appointment of an administrator. In the United Kingdom such a sale may be negotiated by the same advisor who subsequently takes on the role of administrator, notwithstanding any independence implications.[9] A lack of independent oversight and transparency is an often-referenced flaw in the pre-pack model.

It's important to note that the majority of pre-packs in the UK end up seeing the assets (or business as a whole) sold to a related party. Indeed, given the need to set up the sale prior

[9] Note: UK Liquidators do not have the same extensive investigations and reporting obligations as Australian liquidators

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to a formal insolvency appointment, it will always be related parties who are the most likely buyer.

In the Australian context, with the burgeoning crisis of phoenixing already costing the economy (and creditors) billions of dollars each year, proposals like pre-packs that would likely primarily benefit related parties over general creditors/employees are going to be problematic on many levels in meeting community expectations of a fair insolvency system.

In Australia, case law has established very strict independence requirements which prohibit such prior involvement by an external administrator. A summary of the general law independence standards of Australian liquidators and administrators is attached at Appendix B for your ease of reference.

ARITA's Code of Professional Practice articulates this long-established legal requirement for external administrators in Australia to be, and be seen to be, independent.

ARITA's pre-positioned sale option, detailed in our 'A Platform for Recovery 2014' paper, adapts the UK process to introduce elements of independence such that:

- Any advisor retained by the directors in the pre-positioning phase cannot subsequently be appointed in any formal insolvency administration. This is consistent with the current and appropriate, independence requirements for insolvency practitioners in Australia.
- Any sales that occur in the pre-positioning phase must be for value and would be subject to review in any subsequent statutory insolvency administration.
- Any sale of assets undertaken during the statutory insolvency administration, where the terms of sale were negotiated in the pre-positioning phase, would be subject to review by the external administrator prior to being effectuated and the external administrator would be subject to the currently existing statutory and professional requirements regarding the sale of assets.

A pre-positioned sale enables directors to negotiate for a sale of the company, or parts of it, that is concluded either immediately before, or during, a formal insolvency process. Such sales could become more common as a result of advice given under the safe harbour defence. This could create a process analogous to the current practice in the United Kingdom of 'pre-packaged' sales (or 'pre-packs'), wherein preparatory work is done in advance but the sale is conducted at the beginning of a formal administration (before all creditors have been told about the business' failure).

Having contrasted ARITA's pre-positioned sale model against pre-packs, the Productivity Commission recommended[10] that:

[10] Productivity Commission's "Business Set-Up, Transfer and Closure" report released December 2015.

“RECOMMENDATION 14.3

Provision should be made in the *Corporations Act 2001* (Cth) for ‘pre-positioned’ sales.

Where no related parties are involved, there should be a presumption of sale such that administrators can overturn sales only if they can prove that the sale was not for reasonable market value (in accordance with s420A of the Act), or if it would unduly impinge on the performance of the administrators’ duties. Administrators or liquidators should be allowed to rely on the pre-appointment sale process as evidence.

If sales are to related parties, there is no presumption favouring sale and the administrator’s or liquidator’s examination of the sale process continues as normal.

The administrator’s review should include checks that the sale has met existing regulatory requirements for related party transactions.

In both cases, s439A of the Act should be amended to include requirements to disclose information of the sale to creditors [this reporting obligation is now in Insolvency Practice Rule (Corporations) 2016 section 75-225].

Where the sale (whether given effect before or after the insolvency appointment) is the result of advice received under the safe harbour defence, that defence should also apply against voidable transactions actions from administrators or liquidators.”

It is also worth noting that the judiciary have at various times expressed opinions regarding the suitability of pre-packs. In *Korda, in the matter of Ten Network Holdings Ltd (Administrators Appointed) (Receivers and Managers Appointed)* [2017] FCA 91 it was noted that:

> 21 The United Kingdom experience with pre-packs does, however, place in sharp relief a number of the ethical issues that may, or in some cases invariably will, arise where a potential administrator assumes the role of administrator or liquidator. As Professor Finch wrote, for example, in her work *Corporate Insolvency Law: Perspectives and Principles* (2nd ed, Cambridge University Press, 2009) at 460:
>
> > One practitioner has argued that the rapid growth of pre-packs has given rise to ‘unpleasant practices’ in which directors and shareholders of troubled companies are offered ways to shed their creditors and buyback their businesses at very modest cost. The danger, according to this argument, is one of fairness insofar as administrators, banks and directors have strong incentives that may not serve all creditors well:
> >
> > > *The organising administrator has a clear conflict of interest as typically he wants to get the appointment and the management can influence that – such a pre-pack is a good idea for practice development for him and for advising lawyers*. It may suit a bank as it can allow it to participate in the equity going forward in a controlled way or provide it with an assured return potentially at the expense of other creditors. Administrators generally like helping banks.

Steven Davies QC has raised issues of expertise alongside that of fairness in arguing that a small number of 'professional bad apples' who operate via pre-packs facilitate phoenix trading: 'not withstanding considerable antipathy of both the profession and the courts towards phoenix operations, insolvency sales to unscrupulous management still occur and the prepack is the jemmy in the burglar's jacket'.

(Emphasis added, footnotes omitted.)

22 Mr Wellard and Dr Walton further venture the opinion that:

…it is hard to see how any Australian insolvency practitioner who has substantively advised or assisted on the detail of the pre-packaged transaction (i.e. advice going beyond the general availability of a pre-pack as an option) can subsequently take an appointment as voluntary administrator…

…[I]t is clear that an administrator implementing a 'day 1' pre-pack sale will be reasonably perceived by creditors to be endorsing a strategy ultimately controlled or inspired by a company's directors and with which the administrator has been substantively involved prior to appointment. It is contended that detailed involvement and assistance with a pre-pack proposal (particularly a proposed sale to a party connected with the directors of the subject company) would ipso facto disqualify an Australian insolvency practitioner from taking an appointment as voluntary administrator.

(M N Wellard and P Walton, "A Comparative Analysis of Anglo–Australian Pre–Packs: can the means be made to justify the ends?" (2012) 21(3) International Insolvency Review 143 at 162-163.)

23 I agree that it is difficult to imagine a situation in which the taking of such an appointment in the circumstances the authors there describe, which are far removed from the circumstances of this case, would ever be countenanced.

International comparisons

Appendix D to the Discussion Paper references other "pro-creditor jurisdictions" and references Chapter 11 provisions in the United States of America.

We believe that any discussion on Chapter 11 styled changes in the context of your inquiry is misplaced given your focus on the experiences of small and family businesses that operate in a corporate structure and have undergone external administration.

US online legal encyclopedia "NOLO" rather elegantly sums up the use of Chapter 11 for SMEs:

> "Generally, small businesses shy away from Chapter 11, because it is expensive, risky, time-consuming, and complex"

Having considered Chapter 11 in its report, the Productivity Commission concluded[11] that "several factors — including the costs of the process, the role of courts and changes to the roles of creditors and debtors — indicate that the overall costs are disproportionate to any likely gains from a wholesale adoption of chapter 11 of the United States Bankruptcy Code".

[11] Productivity Commission's "Business Set-Up, Transfer and Closure" report released December 2015.

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Appendix A – ARITA Summary: *Sanderson as Liquidator of Sakr Nominees Pty Ltd (in liquidation) v Sakr* [2017] NSWCA 38

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On Behalf Of: (select)

NSW Court of Appeal delivers judgment on liquidator renumeration (Re Sakr)

Posted on 13/03/2017

Today the New South Wales Court of Appeal delivered its much-anticipated judgment on liquidator remuneration in *Sanderson as Liquidator of Sakr Nominees Pty Ltd (in liquidation) v Sakr* [2017] NSWCA 38.

The unanimous (5-0) decision has confirmed that an ad valorem basis of fixing liquidator remuneration by simply applying a percentage rate **without regard to the actual work which was required in the liquidation** is inappropriate. The NSW Court of Appeal also rejected the notion of a different or separate approach to determining reasonable remuneration for 'smaller liquidations'.

ARITA, with leave of the Court, appeared and made submissions as *amicus curiae* on issues of principle relevant to the appeal.

The judgment in *Re Sakr Nominees* is a landmark judicial discussion and statement of principles relating to the determination of liquidator remuneration, including the concept of 'proportionality'. The judgment provides some much-needed clarity and certainty regarding the proper consideration of the factors in s 473(10) of the *Corporations Act 2001* ('the Act').

These same factors are essentially reproduced in s 60-12 of the new Insolvency Practice Schedule (Corporations) (new Schedule 2 to the Act), operational from 1 September 2017.

Primary judgment appealed

Like all appeals, it is important to clarify the aspects of the primary decision - and the asserted errors in that judgment - which were argued before the NSW Court of Appeal.

The primary decision appealed from was that of Brereton J in *Re Sakr Nominees Pty Ltd* [2016] NSWSC 709. A court-appointed liquidator had sought approval of his remuneration under s 473 of the Act, along with special leave under s 488 of the Act to distribute a surplus.

Creditors had earlier approved remuneration (to a capped amount of $197,000) which had been fully drawn. Additional work was required which had not been anticipated at the time of the earlier creditor approval. As all creditors were subsequently paid in full, further remuneration approval by creditors was not possible (as there were no longer any creditors) and court approval was necessary.

Brereton J endorsed an *ad valorem* approach in the course of assessing (fixing) the liquidator's remuneration, on the basis that:

- 'The Court has a very wide discretion in allowing and fixing the level and basis of remuneration'
- Liquidators will 'not necessarily be allowed remuneration at their firm's standard hourly rates for time spent – particularly in smaller liquidations where questions of proportionality, value and risk loom large, and liquidators cannot expect to be rewarded for their time at the same hourly rate as would be justifiable when more property is available'
- Ad valorem remuneration 'is inherently proportionate, and incentivises the creation of value'
- The 1923 English case of *Re Carton Ltd* (1923) 39 TLR 194 provided something of a benchmark for a proportionate rate. (Brereton J observed that in *Re Carton Ltd* remuneration of 5% on realisations and 5% on distributions was described as 'a large commission' which would require 'special circumstances' to justify.)

Brereton J fixed the additional remuneration at $20,000 after concluding that, while the ad valorem approach suggested $195,000 as an appropriate level of reward for the entire liquidation, it had to be acknowledged that there was no objection to the remuneration claim and that there was additional necessary work performed which was not anticipated at the time of the earlier approval.

The issues and arguments on appeal

On appeal, the liquidator submitted that the primary judge had erred in the application of s 473 of the Act for several reasons, including:

- In fixing the additional remuneration at $20,000, there had been no consideration of any of the relevant factors in s 473(10)
- The premise that 'proportionality' is inherently achieved by ad valorem remuneration was incorrect and represented too narrow an application of the concept. Proportionality, submitted the liquidator, was not limited to 'the relationship between

the value of the company's assets and the amount of remuneration'. The relevant question (which the primary judge did not address) was 'whether the value of the work performed was proportionate or disproportionate to the remuneration sought for it'
- A different approach for 'smaller liquidations' is not sustained or justified by the legislation.

Both ASIC and ARITA were granted leave by the Court to make submissions on matters of legal principle (neither addressed the merits of the liquidator's appeal or the quantum of remuneration for which approval had been sought).

ASIC's submissions to the Court supported the primary judge's approach and included the following contentions:

- For 'low asset value' liquidations, 'greater prominence might be given to proportionality as … remuneration will have a greater effect on … any dividend and thus erode confidence in the external administration process'.
- Ordinarily, ad valorem remuneration is preferable for 'smaller liquidations' because it 'provides an easier and cheaper method of determining reasonable remuneration'.
- If liquidators anticipate that their remuneration in 'small liquidations' will be determined on an ad valorem basis, this may 'guide their decision as to what work should be undertaken'.
- Time-based remuneration claims are difficult for courts to verify in the sense of checking 'whether the time taken to undertake the work in question and the amounts charged were in fact reasonable'.

ARITA considered that the legitimate interests of its members and the profession would be served by an amicus appearance. ARITA made the following submissions to the Court:

- The methodology best suited to the calculation of reasonable remuneration - consistent with s 473(10) – is a time-based approach.
- Where agreed prospectively between a liquidator and creditors, a percentage-based method of remuneration is an acceptable approach.
- It is relevant that many tasks undertaken by liquidators 'do not augment either recovery or distribution.' Section 473(1)(a) requires a liquidator to detail the 'necessary' work which has been done and the time spent.
- In identifying 'necessary' work, it will be relevant whether particular work is 'required to be done by legislation or whether the liquidator could have refused to perform the work consistent with his or her professional obligations'.
- Hindsight application of ad valorem remuneration is problematic because it will ignore the quality and difficulty of certain work – factors which are set out in ss 473(10)(d), (e) and (f) of the Act.
- The 'quantum of recoveries and distributions may be completely unrelated to the quality of the practitioner's work'.

- ARITA agrees and accepts that a liquidator seeking court approval of a remuneration claim must discharge the onus of proving that the amount sought is reasonable.
- ARITA accepts that a percentage-based calculation may serve as a useful 'crosscheck' on the question of what is a reasonable amount of remuneration.

The NSW Court of Appeal's decision

In short, the Court held that the primary judge had erred by not considering all relevant factors laid down by s 473(10) of the Act. The appeal was allowed and the application for remuneration was remitted to a judge for rehearing. The leading judgment was delivered by Bathurst CJ and the other four members of the Court agreed with the Chief Justice's reasons.

Three significant errors in the primary judge's approach were identified by the Court.

Firstly, the value of the liquidator's additional work (fixed at $20,000) had not been properly considered in that the primary judge did not appear to have 'considered any of the factors in s 473(10) of the Act relevant to the assessment of remuneration';

Secondly, the primary judge 'erred in his consideration of the question of proportionality'. Bathurst CJ stated that:

'proportionality in terms of work done compared to the size of property or activity the subject of the administration is a relevant factor in fixing remuneration. However, in focusing solely on this issue, his Honour again failed to give consideration to the work actually done and whether the amount to be charged for it was proportionate to the difficulty and complexity of the tasks to be performed.'

Thirdly, the Court held that 'the statute does not mandate a separate approach for smaller liquidations' (while noting that s 473(10)(h) of the Act does render a relevant factor 'the value and nature of any property dealt with, or likely to be dealt with, by the liquidator').

Time based versus ad valorem approaches to remuneration

As for the debate around the virtues and merits of time-based and ad valorem approaches to remuneration, the Court stated that:

'Section 473 of the Act does not provide for any particular method of calculation but refers to remuneration by way of percentage or otherwise. Thus if a judge taking into account the evidence of the work done and the matters in s 473(10) came to the view that remuneration calculated by way of a particular proportion of assets recovered or assets distributed was reasonable, he or she would be entitled to fix remuneration on that basis. Similarly if a judge after considering the work done and the relevant factors in s 473(10) concluded that remuneration calculated on a time basis was reasonable, he or she would be entitled to fix remuneration on that basis.'

However, the Court held that 'it would not … be appropriate to fix remuneration on an ad valorem basis by simply applying a percentage … without regard to the particular work done or required to be done in the liquidation in question.'

Proportionality and the Court's task in assessing remuneration

The Court confirmed that proportionality – 'as a well-recognised factor' – will continue to have a bearing on the Court's task in assessing reasonable remuneration. The Court endorsed the notion of 'proportionality' as explained by the Full Federal Court in *Templeton v ASIC* (2015) FCAFC 137, namely that 'the question of proportionality in terms of work done as compared with the size of the property the subject of the insolvency administration or the benefit to be obtained from the work, is an important consideration in determining reasonableness.'

The Court also endorsed the approach of Black J in *Idylic Solutions Pty Ltd* [2016] NSWSC 1292 (see our case note) that 'evidence as to the percentage that remuneration constitutes of realisations, will at least provide a measure of objective testing of the reasonableness of the remuneration claimed and will identify those cases in which there ought to be a real concern in that respect.'

The Court also stated that the 'evaluative process' of fixing reasonable remuneration, on the evidence presented to it, 'does not seem … to be beyond the competence of the Court' (effectively rejecting ASIC's submission in this regard).

The Court also noted that where work is required and there is 'no evidence that the rates charged or the hours spent were excessive' that will be a 'highly relevant factor' for a court in assessing and fixing reasonable remuneration.

Liquidators' work and outcomes for creditors

In an apparent endorsement of ARITA's submission, the Court made specific mention of two important matters.

Firstly, the Court stated that just because certain work may not actually enlarge the distribution pool for creditors does not mean that a liquidator is not entitled to remuneration for that work. In this regard, the Court specifically referred to a liquidator's statutory minimum obligations. Whether the work was 'necessary' is the critical question: *Warner, Re GTL Tradeup Pty Ltd (in liq)* [2015] FCA 323.

Secondly, the Court observed that liquidators may undertake work in a genuine and reasonable attempt to recover assets but may ultimately be unsuccessful in such endeavours. Again, the Court stated that so long as the decision to carry out the work and amount charged are both reasonable, the liquidator should not be denied remuneration. Indeed, there is a public interest in liquidators bringing such recovery proceedings: *Hall v Poolman* (2009) 75 NSWLR 99.

ILRA 2016: Changes to liquidators' legislative entitlement to remuneration

Going forward, it may be relevant that the current reference in s 473(3) to the liquidator's entitlement to remuneration 'by way of percentage or otherwise' is not reproduced in the new remuneration entitlement provision of s 60-5(1) of the Insolvency Practice Schedule (Corporations). As of 1 September 2017, it is s 60-5(1) which will entitle an external administrator (which includes liquidators, voluntary administrators and deed administrators) to receive remuneration for 'necessary work properly performed'.

Conclusion

The NSW Court of Appeal decision in *Sakr Nominees* provides welcome clarity and certainty on the task of a Court in fixing a liquidator's remuneration and provides comfort for the ongoing use of a time-based approach to remuneration in 'low asset value' liquidations. Practitioners should take note of the principles and approaches endorsed by the Court and incorporate them into the preparation of the necessary material required to support applications to court for remuneration approval (or even approval by creditors in the normal course).

The NSW Court of Appeal appears to have lent support to the view that the legitimate rights of registered liquidators to reasonable remuneration should not be appropriated or discounted to subsidise stakeholders in a winding up.

In the context of the recent report on Phoenix Activity, aspects of the NSW Court Appeal's judgment are a timely endorsement of ARITA's long-held position that more action is needed against those responsible for the management of 'low value asset' companies prior to the arrival of a skilled professional on the scene.

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Appendix B – ARITA Technical Paper: General law independence standards of Australian liquidators and administrators

18 October 2017

ARITA Technical Paper

General law independence standards of Australian liquidators and administrators

Mark Wellard, Legal Director

This paper provides an overview of current general law standards and tests of 'independence' or 'impartiality' applying to liquidators and administrators in Australia, as laid down and enunciated by various decisions of State and Federal Courts over the last 25 years.

An appreciation of landmark and recent authorities regarding the independence of liquidators and administrators informs ARITA's review and consideration of the provisions of its Code of Professional Practice – specifically Chapter 6 – which address and 'set' independence standards for its members.

The summary of relevant authorities below is followed by some observations and commentary, including some possible amendments to Chapter 6 of the ARITA Code.

This paper is intended to inform, promote and encourage consideration and discussion of this important issue within ARITA and throughout the profession.

A. THE LANDMARK AUTHORITIES: THE OVERARCHING TEST OF ACTUAL AND PERCEIVED INDEPENDENCE/IMPARTIALITY

1 *Re Club Superstores Australia Pty Ltd (in liq)* (1993) 10 ACSR 730

This decision of Thomas J of the Queensland Supreme Court has been consistently cited as long-standing authority for the proposition that pre-appointment consultations or conferences can create a want of perceived independence (justifying removal) if the appointee provides advice to directors regarding their personal position and affairs. An impression of having provided personal advice to officers whose conduct may be investigated or warrant action by the liquidator is impermissible and the fact that no fee was earned for such advice is irrelevant. The motives of the practitioner and the absence of actual impropriety are also irrelevant because the guiding principle is one of 'actual and perceived independence'.

2 ***Commonwealth v Irving*** (1996) 65 FCR 291

Branson J of the Federal Court considered an application to remove an administrator due to the administrator's prior personal and professional association with a director. Branson J held that 'the principles which govern issues of actual or potential conflicts of interest, and actual or perceived bias, with respect to liquidators apply equally to administrators appointed under Part 5.3A of the Corporations Law' (now *Corporation Act 2001*).

Branson J held that while 'mere professional acquaintanceship' does not create actual bias or a reasonable perception of bias, 'the authorities make it plain that substantial involvement with a company prior to its administration will disqualify a person from appointment as that company's administrator'. Branson J held that 'such involvement will be seen to detract from the ability of the person to act fairly and impartially during the course of an administration.'

Branson J cited the following key authorities before deciding that it would not be appropriate for the appointee to continue as administrator:

- ***Re National Safety Council of Australia Victorian Division*** (1989) 15 ACLR 355 (Full Court of the Supreme Court of Victoria): 'The guiding principle … is that … [the liquidator] must be independent and must be seen to be independent.' (The liquidator in that case could not be seen to be independent because he was a partner in a firm whose relationship with the company may have required investigation by the liquidator.)
- In ***Re Chevron Furnishers Pty Ltd*** (1993) 12 ACSR 565 the Queensland Court of Appeal considered *Re National Safety Council* and other authorities and concluded that 'the liquidator must have no prior or other involvement either with the company in liquidation, its directors and major shareholders, or one of its creditors so that he could not fairly and impartially carry out his duties as liquidator requiring him, in broad terms, to act in the best interests of the general body of creditors.' The test applied in that case was whether a 'reasonable person aware of all the circumstances would apprehend bias on the part of the liquidators.'
- However, in ***Advance Housing Pty Ltd (in liq) v Newcastle Classic Developments Pty Ltd*** (1994) 14 ACSR 230 Santow J of the Supreme Court of NSW held that some prior involvement by a liquidator is permissible: 'the correct balance is struck by permitting a liquidator to act as such even if there be a prior involvement with the company in liquidation, provided that involvement is not likely to impede or inhibit the liquidator from acting impartially in the interests of all creditors or be such as would give rise to a reasonable apprehension on the part of a creditor that the liquidator might be so impeded or inhibited. In short, the question should be whether there would be a reasonable apprehension by any creditor of lack of impartiality on the liquidator's part in the circumstances, by reason of prior association with the company or those associated with it, including creditors, or indeed any other circumstance.'
- ***Re West Australian Gem Explorers Pty Ltd*** (1994) 13 ACSR 104: Burchett J of the Federal Court held that, of a provisional liquidator appointed by the court and as an

officer of the court, 'there must not be any bias, and there must not be any appearance of bias. Where there are circumstances which might predispose a person to favour particular interests, those circumstances must be taken into account, and the possibility of unconscious partiality should not be overlooked.'

- ***Re Stadbuck Pty Ltd*** (18 May 1993, unreported, Federal Court of Australia) Sheppard J: 'Unquestionably there is a risk that an accountant may, however subconsciously, tend to favour those who have originally consulted him and may, the more readily, fall in with arrangements already made prior to the filing of an application for winding up … the appearances need to be considered.'

- ***Pongrass Group Operations Pty Ltd v Lowerpinems Pty Ltd*** (1994) ACSR 341 Sackville J of the Federal Court stated that 'the guiding principle is that the liquidator should be, and be seen to be, independent' and that 'it is appropriate, in considering whether … [a person] should be appointed, to have some regard both to the values of continuity and efficiency in liquidation.'

3 *Domino Hire P/L v Pioneer Park P/L (in liq)* [1999] NSWSC 1046

An application was brought by a creditor and a director/guarantor for the removal of liquidators who had been commissioned by a secured creditor to act as an investigating accountant and report to the bank on the company's affairs (ie, viability of the business and the bank's security position). The bank subsequently appointed the investigating accountant and his fellow partner as voluntary administrators; the company subsequently entered liquidation. Notices of meetings sent to creditors during the VA omitted to disclose the previous involvement with the company as the bank's investigating accountant. Further, the liquidators, after becoming aware of the court application, took what the judge described as 'the somewhat extraordinary step of attempting to call a meeting of the committee of inspection' to be held two days later, 'for the purpose of having that committee support their position as liquidators.'

Despite there being no valid quorum – meaning that no valid resolution could be passed - the liquidators' lawyers corresponded with the applicants, advising them that the members of the COI present had passed unanimously a resolution confirming support for the liquidators.

Hamilton J decided that the liquidators should cease to hold office:

> *... it is my view that the appearance of lack of independence flowing from the liquidators' actions as the Bank's investigating accountants, particularly when coupled with the events since that time, is quite real. Those events include the omission from notices of meeting of … [the liquidator's] previous involvement with the company, the sending of the misleading communications referred to … and the fact of and circumstances surrounding the calling of the meeting of the committee of inspection ... The occurrence of any detriment to the creditors is unfortunate, but, on the other hand, the courts have emphasised the importance of the reality and appearance of the independence of*

liquidators and, if reality is to be given to those principles, must be prepared to act when they are breached.

4 *Bovis Lendlease v Wily* [2003] NSWSC 467

Austin J ordered the removal of an administrator due to an association with a consultant to the administrator's firm who had acted on behalf of or in the interests of the director prior to the commencement of the administration and then worked for the administrator during the administration. Austin J held that, in the circumstances:

> *a perception arises from the viewpoint of a reasonable bystander that the administrator lacks independence and impartiality. If, as in the present case, the administrator is unaware of the degree of connection between the consultant and the director, it may be that the administrator has not personally lost his or her independence and impartiality. But lack of knowledge of the activities of the consultant is no answer to the claim that there is a reasonable perception of lack of independence and impartiality on the part of the administrator.*

Austin J also stated the following points of principle which are worth extracting from the judgment at length:

- 'Although the distinction is not always observed, there are in fact separate duties relating to independence and impartiality (absence of bias)';
- '*In National Australia Bank Ltd v Market Holdings Pty Ltd* (2001) 19 ACLC 710 Young J (as the Chief Judge in Equity then was) said … that there was a third separate duty, namely the duty of liquidators to ensure that they do not place themselves in a position where there is, or might be, a conflict between their duty to creditors and members and their personal interest, and later he added … that for the principle to apply in a case of possible conflict of interest, there must be a real rather than merely a theoretical possibility of conflict';
- 'In *Re Allebart Pty Ltd* [1971] 1 NSWLR 24, Street J (as he then was) drew attention to the "public responsibilities" that an official liquidator has, as an officer of the Court, to investigate activities connected with the company and in appropriate cases, to initiate proceedings (at 26), and he said "it is essential that the independence and impartiality of a liquidator should at all times exist in point of substance, and be manifestly seen to exist".'
- 'Problems about independence and impartiality can arise because of a connection between the liquidator and the company prior to the commencement of liquidation, or a connection between the liquidator and the directors or major shareholders, or one of the creditors, or because some other facts create a basis for concern. The principles apply quite generally' (citing *Re Chevron Furnishers Pty Ltd (No 2)* [1995] 1Qd R 125, 130)

- ‘a perception of lack of independence may arise where the liquidator's own firm is a potential subject of investigation in the course of the winding up’, citing *Re National Safety Council of Australia* [1990] VR 29

- ‘In some respects (for example, in selling assets or running a business of the company in liquidation) the liquidator can hardly be said to be acting quasi-judicially … it is hard to draw the line as to where the quasi-judicial aspects of a liquidator's task stop and other aspects commence. Yet the duties of independence and impartiality extend to every facet of the liquidator's activities’ (citing *Market Holdings*).

- ‘[T]he courts have unhesitatingly applied the principles regarding independence and impartiality to a liquidator in a voluntary winding up. Thus, in *Re Lubin, Rosen & Associates Ltd* [1975] 1 WLR 122, Megarry J said … that "a voluntary liquidator ought not even to give the appearance of being one-sided" in such matters as organising opposition to a petition for compulsory winding up. The principles were applied in *Advance Housing Pty Ltd v Newcastle Classic Developments Pty Ltd* (1994) 12 ACLC 701, and also in *Re Biposo Pty Ltd* (1995) 17 ACSR 730, to a liquidator who had previously been a voluntary administrator, and had become a liquidator in a "deemed" voluntary winding up’;

- ‘Part 5.3A does not expressly state that the administrator is required to be independent of the directors and any creditors during the administration, or that he or she must act impartially in the discharge of the statutory responsibilities. However, even a cursory review of the scope and objects of Part 5.3A would establish that voluntary administrators have implied duties of independence and impartiality, which are part of the very marrow of voluntary administration system. It has therefore been held that the principles of independence and impartiality developed and applied to liquidators are equally applicable to voluntary administrators (see, for example, *Commonwealth of Australian v Irving* (1996) 19 ACSR 459, at 462) - although differences in the circumstances in which they are required to work (especially the speed at which the administrator must work) may affect the standard required to be observed in particular circumstances’

- ‘Not every prior association will lead to a breach of duty’, citing the *Advance Housing* case (Santow J);

- ‘While it may sometimes be appropriate … to choose as liquidator a person who already has some knowledge of the company, "that consideration is unlikely to have great weight in circumstances where there are divergent interests in the liquidation and the liquidator's familiarity arises from a connection with parties representing some only those interests": *Re Ross Wood & Sons Pty Ltd* (1997) 23 ACSR 291’;

- ‘It is not impermissible, per se, for a liquidator to make an arrangement with a particular creditor for payment of the liquidator's costs and expenses (although, as I shall point out,

it may be material to disclose such an arrangement to creditors). The position was explained by Street J in *Re Allebart* (at 27-28):

> *Not only did the petitioning creditor seek to urge on the liquidator in the process of the windings up, but it agreed to indemnify him against the expenses of carrying out examinations of Mr and Mrs Barton. It had already provided him with a cash sum of over $1,800 to cover the costs of, and related to, the bringing of these examinations. Here again there is no basis for levelling any criticism whatever against the petitioning creditor. Where a company is being wound up and it has no assets, or insufficient assets, to enable the due processes of the liquidation to be carried through, a creditor is to be encouraged, rather than criticised, in making funds available to the liquidator. Nor need a liquidator be diffident in accepting funds or indemnities from creditors so as to enable a winding up to proceed. Moreover, I see no reason to criticise on the grounds of propriety the arrangement under which a creditor provides money or indemnities to cover the expenses of a specific step in the winding up, such as the bringing of named proceedings or the carrying out of named examinations. Arrangements such as these are commonplace, and, if anything, they are to be encouraged, as very frequently some such arrangement enables the liquidator to carry out his duties more thoroughly or comprehensively than would otherwise be the case.*

- 'The principle of independence has also been "slightly eroded" in other respects, such as by "(a) the practice to permit a company which has consulted an insolvency accountant about its future and has been advised to go into liquidation to nominate that accountant as liquidator; (b) the practice to permit a voluntary liquidator to be appointed who has given financial advice to the directors …": *Market Holdings*, at 733. In *Re Club Superstores Australia Pty Ltd* (in liq) (1993) 11 ACLC 351 Thomas J accepted that there was a common practice in Queensland for a potential liquidator to attend a pre-appointment conference with a creditor or the company's directors, which did not contravene the duties of independence and impartiality. However, the potential liquidator needed to be careful not to "cross the line" by giving personal advice to the persons in attendance'
- '[T]he principles about independence and impartiality draw attention not only to the facts but also to the perception that the facts create. Olsson J has reminded us that "for those who have a particular perception, that perception is the reality": *Re Dunquil Pty Ltd* (1985) 9 ACLR 950, 955. In *Re Biposo* Young J (as his Honour then was) emphasised the importance of the perception of impartiality, and (at 735) saw the primary problem in the case before him as being "whether it would be perceived by a reasonable observer that the liquidators have manifested tendency to favour certain interests at the expense of others"';
- In an application for a liquidator's removal, 'the question is not whether a case of wrongdoing has been proven according to the particulars given by the plaintiff, but rather "whether in the interests of the public removal of the liquidator would be for the general

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advantage of persons interested in the winding up". This principle has frequently been applied in applications for removal of liquidators (*City & Suburban Pty Ltd v Smith* (1998) 28 ACSR 328, 336; *Citrix Systems Inc v Telesystems Learning Pty Ltd* (1998) 28 ACSR 529, 536), and in applications for the removal of administrators (*Network Exchange Pty Ltd v MIG International Communications Pty Ltd* (1994) 13 ACSR 544; *Dallinger v Halcha Holdings Pty Ltd* (1995) 60 FCR 594; *Velkovski v Ryan* (1996) 19 ACSR 514). Questions of independence and impartiality also arise, and are similarly treated, where an application is made for leave under s 448C for a person to be appointed administrator: *Re Central Spring Works Australia Pty Ltd* (2000) 34 ACSR 164; *Re St George Builders Hardware Pty Ltd* (1995) 18 ACSR 451';

5 *Re Monarch Gold Mining; ex parte Hughes* [2008] WASC 201

Upon an application by administrators for an order (direction) that they continue in office, Master Sanderson of the Western Australian Supreme Court stated that 'the test … of independence is a conflict based test - negatived if the evidence establishes 'a real and not merely a theoretical possibility of conflict': see *National Australia Bank Ltd v Wily* [2002] NSWSC 573 [22]'. Master Sanderson stated the following points of principle:

> *The court is not required to assess whether the administrators will act independently, but only to assess whether there is a reasonable apprehension based on existing or past events that the administrators will not act independently. The authorities show that a mere theoretical possibility of conflict is not sufficient. Independence must be assessed by reference to such things as whether the appointee administrators have, prior to their appointment:*
>
> *a) performed professional services of a sufficiently material nature on behalf of a principal creditor of the company to suggest that there is a reasonable apprehension they will not act independently;*
> *b) provided professional services of such a degree of magnitude to the company over a long period and of such a nature as to put in doubt their capacity to independently discharge their office;*
> *c) acted as auditor of the company;*
> *d) acted with clear evidence of bias in the conduct prior to the application being made;*
> *e) a close personal relationship with interested parties;*
> *f) a close relationship with a creditor such that there was a clear tendency to prefer the interests of that creditor.*
>
> *These principles emerge from a number of cases including Domino Hire Pty Ltd v Pioneer Park Pty Ltd (in liq) (2003) 21 ACLC 1330; Re Ross Wood & Sons Pty Ltd (in liq) (1997) 23 ACSR 291; Re Biposo Pty Ltd (1995) 13 ACLC 1271 and BL & GY International Co Ltd v Hypec Electronics Pty Ltd (in liq) [2004] NSWSC 1119.*

Master Sanderson accepted that the evidence did 'not disclose any matter substantiating any of the six criteria … set out above' and also accepted that:

- a ‘limited prior involvement of an administrator with directors is a recognised exception to the rule that prior relationships affect independence: see *National Australia Bank Ltd v Market Holdings Pty Ltd (in liq)* (2001) 37 ACSR 629 [194] (Young J)’;
- ‘providing preliminary insolvency advice will not disqualify an insolvency practitioner from acting as an administrator: see *Commonwealth v Irving* (1996) 65 FCR 291, 296. Indeed, given that it is for the board to decide whether an administrator should be appointed, not to take some preliminary advice may be seen as a breach of directors' duties. Having taken that advice, it is logical that the person giving the advice, having familiarised himself with the affairs of the company, should be appointed administrator.‘

Master Sanderson identified the following matters, none of which justified refusing orders that the administrators may continue in office:

- One of the administrators (Hughes) had, prior to his appointment, provided professional services to the company (two short engagements):
  - The first was an engagement to attend three meetings of management and the board: advice was given about some solvency matters involving the delivery of reliable information by management to the board (not advice about the financial solvency of the company at the time) and a fee of $9,000 was paid. This was held to fall within the exception of limited prior involvement with directors: *NAB v Market Holdings* (2001) 37 ACSR 629 [194];
  - The second was a pre-appointment engagement, some two weeks prior to appointment. This was held to fall within the ‘preliminary insolvency advice’ exception to disqualification: *Commonwealth v Irving*.
- There was a personal relationship between Hughes and a director, including another liquidation in which Hughes acted as liquidator of a group of companies which had the same director. Also, one tax partner of Hughes’ firm acted for that director in his personal capacity in respect of entities unrelated to the immediate appointment. Hughes (and his fellow administrator) was not personally involved nor undertook that work. Master Sanderson held that he was ‘not satisfied that there is anything in the evidence or in the nature of the prior relationship … which could lead in any way to a conclusion that he was unsuitable to act as administrator.’

Master Sanderson also made a requested order that (replacement) DIRRIs were tabled in accordance with the then IPA Code, making the order out of regard for the importance of the Code (though it ‘has no legal status’, the Code ‘is something more than a public relations exercise’).

6 *Commonwealth Bank v Fernandez* [2010] FCA 1487

Finkelstein J was required to consider whether to appoint a bank’s nominee as substitute administrator. At [64] and [64] Finkelstein stated:

It was once the rule that that an insolvency practitioner should not take up the office of liquidator or administrator if s/he had prior dealings with the company, its directors, major shareholders or creditors: Re Chevron Furnishers Pty Ltd (in liq); Qld Amalgamated Industries Pty Ltd v Harris [1995] 1 Qd R 125, 130. But, as with so many sound rules, commercial expediency has led to them being watered down. In National Australia Bank Ltd v Market Holdings Pty Ltd (in liq) [2001] NSWSC 253 … Young J acknowledged (at [194]) that the rules have been "slightly eroded" by three practices: (a) permitting a company which has consulted an insolvency accountant about its future to nominate that accountant as liquidator; (b) permitting a voluntary liquidator to be appointed who has given financial advice to the directors; and (c) permitting creditors to nominate a liquidator in an ordinary winding up in insolvency. In this case I am asked to erode the principle by one more practice – permitting an administrator to be appointed who has given advice about the mortgagor to the secured creditor.

Finkelstein J considered an investigative accountants report prepared by the bank's nominee to be 'an innocuous affair' which merely identified topics for further examination. It was held that the work done for the bank by the proposed appointees should not be seen to be disqualifying. The appointees were also required to engage lawyers who were independent of the bank, not due to any concern for the actual independence of the appointees but out of regard for the 'legitimate concerns of creditors'.

Finkelstein's judgment at [68] to [88] is noteworthy for the discussion of the 'problem' caused by the Part 5.3A system of 'private ordering' of administrators.

7 *Walton Construction* (2014) FCAFC 85

In *Australian Securities and Investments Commission v Franklin (liquidator), in the matter of Walton Construction Pty Ltd* [2014] FCAFC 85 the Full Federal Court upheld the removal of liquidators due to a 'referral relationship' with a party which was involved in pre-administration transactions.

The Court concluded that a 'fair-minded observer' might think that, by reason of the referrer's relationship with the liquidators' firm, the liquidators might be 'more amenable to its interests than others might be.' This has been described as the 'double might' test.

The Court held at [95] that the fair-minded observer would regard the remuneration received by reason of the referral relationship as 'significant' and therefore 'might apprehend that … [the liquidators' firm] may not wish to put their continued receipt of income ... in jeopardy.'

The Court at [104] also drew the analogy of the principle that 'litigants do not get to choose their judges' and therefore decided that the fair-minded observer might reasonably think that the referrer's involvement in pre-administration transactions – which will be investigated – and their role in influencing the appointment of those who would conduct the investigations 'were causes for disquiet.' Therefore, the liquidators 'had an interest which conflicted with their duties' and the Court held at [126] that this 'would add to the apprehension of the reasonable fair-minded observer.'

The Court noted the observation of Spigelman CJ in *McGovern v Ku-ring-gai Council* [2008] NSWCA 209 that '[when] a relevant conflict of interest is established the reasonable apprehension follows almost as of course'.

8 *Ind Energy Inc v Langdon & Anor* [2014] WASC 364:

This case involved an application to discharge administrators. At [109], Heenan J stated that:

> *The roles of administrators in the course of performing their tasks in an administration have been examined by Austin J in Bovis Lend Lease Pty Ltd v Wily [133], by Sanderson M in Re Monarch Gold Mining Co Ltd; Ex parte Hughes [2008] WASC 205; (2008) 26 ACLR 1089 [15] and by Corboy J in Hughes v The Receivers and Managers of Westgem Investments Pty Ltd [No 3] [2012] WASC 360 [17]. They require that administrators be, and be perceived to be, independent of the company, its directors and shareholders and individual creditors; act, and be perceived to act, impartially in discharging the duties and responsibilities of their office; and ensure that they do not place themselves in a position where there is, or might be, a conflict between their duty to creditors and their personal interest. The plaintiffs submit that an administrator is a trustee and has the same duty of impartiality as courts of equity impose on trustees: Commonwealth Bank of Australia v Fernandez [2010] FCA 1487; (2010) 81 ACSR 262 [63], a proposition which I accept. …*

At [145] - [146] Heenan J referred to the decision of Beech J of the Supreme Court of Western Australia in *Flynn v Theobald* [2008] WASC 263 (emphasis added):

> *[145] Beech J … went on to examine the principles applicable to the determination of applications for removal of administrators at [105] - [110] and, in doing so, referred to the dicta of Byrne J in Smarter Way (Aust) Pty Ltd that the engagement by administrators of a company of the solicitors retained by the appointing charge-holder is generally undesirable. In that case at [26] Byrne J said:*
>
>> *It will often occur that the interests of the appointor, whether this be the board of directors of the company or a chargee, are and may be in conflict with the interests of the company's creditors or its members. The often burdensome duty of the administrator is to stand firmly and independently between these competing interests: see Central Spring Works of Australia Pty Ltd (2000) 34 ACSR 164 at [13] - [14] per Warren J.* ***In particular, it is important that the administrator not act or not appear to act merely at the bidding of the appointor to whom, it may be thought, they owe their employment as such. This may be of particular importance where the appointment is made by the directors who may wish to present a deed of company arrangement to the creditors with the support of the administrator's opinion in the s 439A(4) report. In such a case, the creditors are entitled to the independent opinion of the administrator as well as a full and accurate report of the matters specified in that section and in the regulations made under it****: see McVeigh v Linen House Pty Ltd [2000] VSCA 4 at [39] - [43]. In principle, the creditors and members of the company are entitled to the*

> *same professional independence from an administrator appointed by a chargee. (emphasis added)*
>
> *[146] In my respectful view, these observations of Byrne J can also be applied by analogy to any suggested relationship between an administrator and a particular creditor or claimant whether an appointing creditor or not. No creditor or claimant may be permitted to have or permitted to be seen as having an influence over an administrator which may support or distract the administrator's attention from acting in the interests of the company and the creditors as a whole.*

B. RECENT INSTRUCTIVE EXAMPLES OF PERMISSIBLE AND IMPERMISSIBLE APPOINTMENTS

The 'right' side of the line

Instructive cases where the practitioner has been held to be justified in remaining as administrator or liquidator include:

9 ***Queensland Mining Corporation Ltd v Butmall Pty Ltd, in the matter of Butmall Pty Ltd (in liq)*** [2016] FCA 16

An application was brought by a director of a company for the removal of liquidators because of an actual or apparent conflict of interest. The liquidators were partners of a firm in which another partner was 'auditor of the major creditor'. The director argued that the company had two potential claims against the relevant creditor and that 'a reasonable observer might perceive that the liquidators might not bring an independent mind to bear upon the assessment of those claims, thereby giving rise to an apparent conflict of interest.'

After noting the principles stated in *Walton Construction* (including the 'double might' test), the judge concluded that there was nothing which had been put to the Court which satisfied the requirement 'that there be a real and not merely theoretical possibility of a conflict of interest.' The first claim referred to by the director was compromised by an issue estoppel issue and was not available. As regards the second claim, there was an *Anshun* estoppel issue which again infected the claim.

Thus, the judge concluded, 'it cannot be said that there is a real as opposed to a merely theoretical possibility of any conflict of interest arising'. Further, Jagot J stated:

> *[T]here is nothing particularly unusual about a firm having a relationship with a creditor, in this case the relationship being that BDO is the auditor of QMC. It is Butmall that is the company subject to the liquidation. There is no suggestion of any potential conflict of interest in that regard, other than by reason of the allegations of the two claims by Butmall against QMC. The inference is said to be that a reasonable person might perceive that by reason of the existing auditor relationship between BDO and QMC, BDO might not bring an independent mind to bear upon the assessment of those claims. As I have said, this might have some substance if I could be persuaded that the claims were*

in any way reasonably arguable. The problem for this application is that, as matters presently stand, there is no basis upon which I could be satisfied that the claims are reasonably arguable. In any event, as has been said in the affidavit of Mr White, Mr Renshaw has not provided any information to the liquidators about the potential claims as requested (apart from this application).

10 ***Mighty River International Ltd v Hughes and Bredenkamp*** [2017] WASC 69 (subsequently appealed, but not on the question of independence)

The case involved an allegation of perceived bias – justifying removal – because of the extent and nature of contact between prospective appointee administrators and a board contemplating an appointment. It was alleged that the administrators were not independent due to pre-appointment discussions with the board which included common directors (ie, directors of another related corporate shareholder with an interest in the administration). It was alleged that by talking to the board of the company the administrators in their pre-appointment discussions were effectively talking to that other related corporate shareholder, to the disadvantage of the applicant which was another corporate shareholder and creditor.

The decision was that there was no apprehended bias. The Court held that it cannot be the position that a prospective administrator must refuse an appointment upon realising that advice to a board is 'finding its way' to a corporate shareholder. If that were the case, then 'a prospective administrator in discussions with the board of a company which was a subsidiary could never accept appointment as administrator.'

As for an alleged predisposition towards a 'holding DOCA', the Court held that relying on experience and expertise to initially favour a holding DOCA, while keeping an open mind, is not an approach which shows a predisposition which amounts to bias.

Regarding pre-appointment procedure, Master Sanderson stated (emphasis added):

It is one of the striking features of pt 5.3A of the Act that the role of the court is limited. It is left to the board of a company to decide whether or not they should appoint administrators. The legislature could have required a board, if it thought administrators should be appointed, to get that decision reviewed by the court. They could also then have allowed the court to appoint the administrators. What the Act does is throw the onus on the board. That must of necessity mean the board should get advice from potential administrators as to the proper procedure to be followed and the consequences of administration. The potential for a conflict of interest must arise in almost every case. After all, the administrators once appointed are obliged to investigate the conduct of the directors in relation to the affairs of the company. They may well decide the company has an action against the directors. It is only natural most directors should look for an administrator who was 'tame'. But it is the duty of the administrator once appointed to bring all his or her skill and resources to bear on the administration with a view to providing the best possible outcome both for creditors and shareholders. So administrators have to tread a fine line. On the one hand, they have to advise a board - and not individual board members - as to the consequences of administration.

On the other hand, they have to bring to the attention of the board the requirements of the law and their obligations to investigate the conduct of the directors.

In this case there was no doubt in my mind Mr Hughes did everything possible to ensure independence. The advice he gave the board of Mesa was minimal and could not be in any way construed as benefiting Mineral Resources [a shareholder] or the directors. His conduct was exemplary. In arranging for Mesa to obtain a valuation of its assets he took the first logical step to obtain an idea of Mesa's financial position. He did not at any time advise individual board members of Mesa - he directed his advice to Mesa. He did not advise Mineral Resources and whatever was passed on by the board of Mesa to Mineral Resources was entirely beyond his control. In my view, there exist no grounds at all under s 445D for termination of the deed. Nor are there any grounds for removing Mr Hughes and Mr Bredenkamp and replacing them with other administrators.

11 *Re Recycling Holdings Pty Ltd* [2015] NSWSC 1016

This NSW Supreme Court case involved another allegation that a reasonable apprehension that deed administrators were biased had arisen due to certain pre-appointment discussions.

Brereton J stated at [94] and [96] (emphasis added):

It is not in doubt that, like liquidators, administrators and deed administrators are expected to be free of actual or potential conflicts of interest and actual or apparent bias *[Commonwealth of Australia v John Irving (1996) 65 FCR 291; 144 ALR 172; 14 ACLC 645; 19 ACSR 459, 462 (Branson J); Bovis Lend Lease v Wily, [133]-[141]; Re West Australian Gem Explorers Pty Ltd (1994) 13 ACSR 104, 106 (Burchett J); Re Monarch Gold Mining Co Ltd; Ex parte Hughes [2008] WASC 201, [15]].* ***Apprehended bias will be established if a fair minded lay observer might reasonably apprehend that the administrators might not bring an impartial mind to the resolution of questions they may be called upon to decide*** *[ASIC v Franklin [2014] FCAFC 85; (2014) 223 FCR 204; 101 ACSR 87, [58]-[64] (White J)].* ***That said, the court will remove and replace an administrator only if satisfied that to do so would be "for the better conduct of the administration"*** *[Network Exchange Pty Ltd v MIG International Communications Pty Ltd (1994) 12 ACLC 594; 13 ACSR 544, 549-551 (Hayne J); Re Central Spring Works Australia Pty Ltd (admin appointed); Tubemakers of Australia Ltd v McLennan (as admin of the company) [2000] VSC 145; (2000) 34 ACSR 169; Phoenix Lacquers & Paints Pty Ltd v Free Wesleyan Church of Tonga In Australia Inc (admins apptd) [2012] NSWSC 214; (2012) 260 FLR 348; 87 ACSR 658, [45] (Black J)].* ***That requires that attention be given to the stage of the administration, and the remaining functions of the administrator or deed administrator****. In the present case, now that a DOCA is in place, the main remaining functions of the deed administrators are receiving and adjudicating proofs, distributing the deed fund, and exercising such discretions as they have under the DOCA. The essential question is whether the reasonable bystander would, in the context of the*

DOCA, apprehend that the administrators might not bring to those functions an impartial mind …

the question is not whether what took place was fully described in the DIRRI, but whether what took place manifests a want of independence *… The pre-appointment process involves administrators considering whether or not they will consent to an appointment. Administrators are entitled, before consenting to appointment, to have some idea of what it is that they are being asked to take on. It is to be expected, and it is unexceptionable, that the matters addressed will include the assets and liabilities of the company. And* ***as one of the potential outcomes is a DOCA - particularly where the appointment is to be made by a liquidator under s 436B – pre-appointment discussions will not unreasonably involve a discussion of the potential terms of a DOCA with the proponent. It is to be expected that in the course of considering whether or not to accept an appointment, administrators will think about and perhaps form some preliminary views in respect of a DOCA****. Essentially, in this case – as in many – the most important issue for the administrators was their recommendation to the creditors meeting. Predisposition towards a DOCA – particularly in the context of an appointment by a liquidator under s 436B – does not indicate disqualifying bias in favour of one interest or against another.*

12 *In Walley, in the matter of Poles & Underground Pty Ltd (Administrators Appointed)* [2017] FCA 486

In this Federal Court case, liquidators applied to court for a direction that they were justified in remaining in their role as the appointed liquidators in a winding up which followed a voluntary administration. The application came about due to a question raised at the VA second creditors' meeting regarding the liquidators' (then administrators') prior professional relationship with the company: the administrators had performed some pre-appointment work under an engagement to provide 'certain accounting services.' The services performed were a review of – and report on – the company's financial affairs/performance and 'came to include' the provision of reports to the company's secured creditor and weekly and monthly reports. One of the liquidators was the 'lead partner' in the firm who worked on the pre-appointment engagement. The liquidators' firm charged and received $95,000 for the engagement prior to the administration.

The DIRRI for the appointment as administrators 'described the previous investigating accountant engagement and set out the reasons why the administrators considered that the engagement did not give rise to any "impediment or conflict".' The DIRRI also disclosed the receipt of $95k for the services provided under the pre-appointment engagement. The liquidators, having identified two potential conflicts of interest (the fees received and the pre-appointment work), dealt with the first by repaying the fees to the liquidation bank account. That left the issue of the liquidators' work on the pre-appointment engagement. No creditor sought the removal of the liquidators and the liquidators submitted to the Court that while there was a 'potential' for the prior involvement to give rise to a conflict of interest it was only a 'theoretical prospect' and that they were 'not aware of any particular reason why their

previous involvement is likely to impede or inhibit them from acting impartially, or to give a reasonable apprehension on the part of a creditor that the liquidators might be so impeded or inhibited.'

The liquidators made the application 'in recognition of the liquidators' obligation to bring matters of conflict to the attention of the Court, identified in *Australian Executor Trustees Ltd v Provident Capital Ltd, re Provident Capital Ltd (recs and mgrs apptd) (in liq*) [2013] FCA 1461 at [11] to [14]' (per Rares J) and 'mindful that the issue was raised by a creditor at the second meeting of creditors.'

After referring to authorities including *Advance Housing*, *Walton Construction* and *Domino Hire v Pioneer Park*, the Court held that, 'applying the approach of Santow in *Advance Housing*, the correct balance is struck by permitting a liquidator to act despite a prior involvement with the company, provided that involvement is not likely to impede or inhibit the liquidator from acting impartially or be such as would give rise to a reasonable apprehension on the part of a creditor that the liquidator might be so impeded or inhibited.'

No creditor had 'expressed any apprehension of a lack of impartiality' or 'raised any complain concerning the propriety of the liquidators remaining in office' which, according to Gleeson J, distinguished the circumstances from the cases of *Advance Housing* and *Domino Hire*. Gleeson J accepted that it was in the best interests of the companies that the liquidators' appointment continue 'particularly having regard to the fact that the liquidators have substantial knowledge of the affairs of … [the company] which is likely to assist in the efficient conduct of the liquidation for the benefit of all creditors'.

The 'wrong' side of the line (or slightly so)

Instructive cases where Courts have held that the practitioner should either be removed or partially 'replaced' by special purpose liquidators include:

13 *Bank of Queensland Ltd & Anor v Ross Auto Auctions P/L (in liq) (Receivers & Managers Appointed) & Anor* [2015] QSC 347

Creditors applied to Court for the removal and replacement of a liquidator on four grounds including (principally):

- An apprehension that his referral relationship with Insolvency Guardian (IG) might compromise his independence. IG was a creditor of the company for some $21,000 for pre-appointment services rendered to the company and its directors;
- The proposed replacement liquidator would be funded by the first applicant creditor to investigate the affairs of the company and pursue any warranted claim.

Naturally, the decision in *Walton Construction* loomed large both in argument and the Court's decision. While – unlike in Walton Construction – there was no evidence that IG was involved in any transactions which would be investigated, McMurdo JA noted that 'there is here clearly a history of frequent referrals of work by IG to … [the liquidator's] firm.' The

liquidator conceded that 'the majority of his appointments as a liquidator in a CVL for a Queensland based company' for the past year had been 'as a result of referrals from IG.'

There was no evidence of any 'agreement or particular understanding with IG from which his performance of liquidator might be compromised.' There was no allegation of 'actual bias'. However, the judge concluded that 'there is a reasonable apprehension of bias' when one considered the 'strong possibility' that investigation of actions the directors took prior to liquidation 'would extend to the advice the director received in doing so and that this would involve an investigation of the conduct of IG.' That investigation 'could be adverse to IG's interests.' There was also an ongoing retainer of IG by the director which reinforced the view of apprehended bias.

The Queensland Supreme Court judge held that 'this is a case, as in … [Walton Construction], where an entity (IG) appears to have influenced the selection of the person who, as liquidator, would investigate its own pre-administration conduct.'

The applicants had therefore shown cause for the liquidator's removal. The possible advantage of prosecution of potential claims was 'supportive' (though not determinative alone) of the case for removal. The liquidator's removal was ordered by the Court.

The subsequent decision on costs is interesting: see [2016] QSC 19. The liquidator was ordered to pay the applicants' costs but was entitled to indemnification from the assets of the company.

14 *State of Victoria v CTM Training Solutions Pty Ltd (In Liq) & Ors* [2017] VSC 47

A creditor asked the court to appoint special purpose liquidators so that it could fund investigations to be undertaken by those special purpose liquidators (including into possible breaches of directors' duties, insolvent trading and voidable transactions). The creditor did not seek removal of the existing liquidators but did not want the desired investigations undertaken by the existing liquidators who had been 'selected by the directors'.

Sifris J ordered the appointment of special purpose liquidators, partly due to a concern about the 'appearance of impartiality' because a director of two related companies which would be the subject of the desired investigations had previously engaged the existing liquidators' firm in other CVLs. (The proposed SPLs were also acting as liquidators of those other related companies which would provide efficiencies in carrying out the desired investigations in relation to all relevant companies). Further, the existing liquidators had only started investigations after the commencement of the creditor's application for SPLs, which Sifris J stated did 'not inspire confidence'.

Emphasising the importance of perception as opposed to an actual want of independence, Sifris J stated that

> *I wish to stress that I make no adverse findings against the Liquidators. I should also stress that it is of the first importance that liquidators are totally independent and are*

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seen to be so. It is important that confidence in the integrity, objectivity and impartiality of an administration be maintained [citing Apple Computer Australia Pty Ltd v Wily (2003) 46 ACSR 729 in which Barrett J at [36] – on the question of independence – endorsed the dicta in Advance Housing Pty Ltd v Newcastle Classic Developments Pty Ltd and Re Biposo].

15 *Deputy Commission of Taxation, in the matter of WD Hall Pty Ltd v WD Hall Pty Ltd* [2017] FCA 767

Derrington J of the Federal Court, in considering a winding up application, had to resolve a dispute as to who should be appointed liquidator. It was considered appropriate that the company be wound up but an administrator had already been appointed. Derrington J cited the 'most often repeated' of matters in the guiding principles established by the authorities, namely 'that the person to be appointed must not only be independent of the Company but must be seen to be independent.' Derrington J referred to the decisions in *Re National Safety Council* and *Bovis Lend Lease v Wily*.

The issue was raised regarding the administrator's 'prior association' with the company. Derrington J did not consider that matter alone sufficient to prevent the practitioner being appointed as liquidator (indeed, cost savings can be achieved where such an appointment is made). However, Derrington J did consider that 'the absence of any information whatsoever as to how he became appointed as the administrator is not irrelevant to the consideration of the Court.' Derrington J noted that, notwithstanding the proffered consent to act as liquidator which indicated no awareness of any conflict of interest or duty and notwithstanding there was no suggestion of actual impropriety, there was 'very little information before the Court as to the exact nature of the relationship between … [the administrator] and the director of the Company.'

Derrington J stated that, where the administration occurred after the filing of a winding application, it would have been 'useful' to have some evidence before the Court as to the nature of the relationship between the administrator and the company prior to his appointment as administrator. It was also relevant that no DOCA proposal had emerged. The familiarity of the administrator with the affairs of the company, while relevant, was considered outweighed by the lack of evidence as to the nature of the pre-appointment relationship between the administrator and the directors of the company and the wishes of the largest creditor (ATO) to have another practitioner appointed.

16 *Korda, in the matter of Ten Network Holdings Ltd (Administrators Appointed) (Receivers and Managers Appointed)* [2017] FCA 914

In this case, the key issue identified by the judge was 'the terms upon which administrators appointed pursuant to s 436A of the *Corporations Act 2001 (Cth)* (the Act) may continue to act when, in their prior capacity as "potential" or "putative" administrators, they have had recent, long-term, substantial and remunerative involvement with the company or companies to which they are appointed.'

There was no contest as to the form of the final orders which were made in the application brought by the joint administrators, namely that a separate registered liquidator be appointed to prepare a limited report (to be part of the ultimate s 439A report) on:

> '(i) any claims arising from the conduct of the directors, officers, advisors (including … [the companies' lawyers]) and/or [the joint administrators' firm] as prospective administrators of each of [the Ten Group Companies] prior to the appointment of the … [joint administrators]; and
>
> (ii) whether the remuneration received by … [the joint administrators' firm] in respect of work undertaken by … [the joint administrators' firm] prior to the appointment of the … [joint administrators] are voidable preferences.'

Further, the Court ordered that this specially-appointed registered liquidator:

> 'supervise the … [joint administrators'] conduct so as to satisfy himself that the … [joint administrators] are acting consistently with their statutory duties and fiduciary obligations as administrators of [the Ten Group Companies], in relation to any claims which … [the specially-appointed registered liquidator's firm] identify in the report prepared pursuant to this Order that the … [joint administrators] may pursue or should further investigate.'

But O'Callaghan J observed that

> *the parties did not agree, however, about the reasons for making the orders. ASIC submitted that the orders were necessary to cure a reasonable apprehension of bias. The administrators, on the other hand, reject the proposition that a reasonable bystander might think that anything … [the joint administrator] did as potential administrator could give rise to any relevant reasonable apprehension of bias, and that it is, for present purposes, sufficient, without making any finding on the apprehended bias issue, to make the order because the voluntary disclosures "cured" any apprehension of bias created by the matters concerning … [the companies' lawyers] and the pre-appointment payments made by that firm to … [the joint administrators' firm].*

The relevant pre-appointment involvement of the 'potential administrators' was their engagement by the Ten Group's lawyers to 'prepare an administration contingency plan' in case that informal restructuring negotiations were unsuccessful. The joint administrators' firm received payment of around $1 million for this work which included 'approximately 50 meetings' with Ten management, directors, financiers, shareholder guarantors and advisers over the course of three and a half months. The judge stated that the joint administrator who had the relevant pre-appointment involvement 'was not in any sense retained to be, nor did he act as, a professional adviser to the Ten Group, the board, management or any other director.'

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O’Callaghan J agreed with the submissions of ASIC that:

> *provided that safeguards are erected that guard against the existence or appearance of any conflict of interest, should an appointment subsequently prove necessary, then the fact that significant, long-term and highly-paid work is undertaken – for the purposes of planning and preparing for a prospective administration to which those planners and preparers are subsequently appointed – should not of itself cause a reasonable apprehension of bias.*

The judge accepted the proposition that:

> *a fair-minded lay observer might reasonably apprehend that the administrators might not bring an impartial mind to the resolution of two issues:*
>
> *(1) the fact that the administrators were appointed by … [Ten Group’s lawyers], have a referral relationship with that firm, were paid by that firm and may have to investigate it; and*
>
> *(2) the fact that the administrators will have to consider, in the course of their investigations and reporting, whether their pre-appointment payments are voidable preferences in any subsequent liquidation.*

Three other aspects of O’Callaghan J’s reasons for judgment are noteworthy:

- The determination that ‘[t]he fair-minded observer is not to be understood as being restricted to a fair-minded creditor, whatever suggestion to the contrary might be found in some of the cases.’
- The determination that disclosure in a DIRRI cannot operate to cure an apprehension of bias
- The discussion of UK pre-packaged administrations which, while very different to the pre-appointment involvement being considered by the Court in this case, ‘place in sharp relief a number of the ethical issues that may, or in some cases invariably will, arise where a potential administrator assumes the role of administrator or liquidator’.

O’Callaghan J noted that in the immediate case of pre-appointment involvement which was required to be considered by the Court:

> *It is critical to understand, in this case, that the character of the work that … [one of the administrators] described in his evidence, and which ASIC accepts describes that which a potential administrator may properly perform, bears no relevant resemblance to the work performed, and advice given, by practitioners in the United Kingdom and elsewhere engaged in concluding an agreement in advance of statutory administration. As explained below, … [one of the administrators] swore, and I accept, that neither he nor anyone else from his firm provided advice to the board, the directors or the management of the Ten Group, or to any of its creditors or other stakeholders, in*

relation to the management of the Ten Group, its affairs, its insolvency, or the obligations and duties of the board, individual directors and management.

No argument was made by any stakeholder that the administrators be removed, which the judge accepted would be 'disproportionate' and 'wholly unnecessary'.

C. SOME OBSERVATIONS AND COMMENTS

Pre-appointment involvement, 'independence' and 'impartiality'

Following the judgment of the Full Federal Court in *Walton Construction*, it might be said that subsequent decisions have seen a conflation of the duties of 'independence' and 'impartiality'. The liquidator's duty of investigation was the focus of the Court's consideration in *Walton Construction*. Cases subsequent to *Walton Construction* have tended to focus on duties of investigation as opposed to the other aspects of the role of an administrator (including other duties and powers of an administrator).

This is an observation, not a criticism. Cases which come before Courts are invariably driven by their own facts and circumstances. It is probably unsurprising that keen attention is given to issues of independence affecting the appointee's duties to investigate and review pre-appointment affairs and transactions.

However, one wonders whether the recent line of cases addressing concerns for proper review and investigations has diminished awareness of the broader context and application of the established principles. As Austin J stated in *Bovis Lendlease v Wily*, '[a]lthough the distinction is not always observed, there are in fact separate duties relating to independence and impartiality (absence of bias)'.

An administrator's duties extend beyond that of investigations. When considering the perception of a 'fair-minded observer' who is aware of an administrator's prior association with a company and its directors, it is relevant to note that:

- The key role of an administrator is to provide a recommendation on a DOCA or liquidation in the voluntary administrator's report which is prepared for the second meeting of creditors (previously under s 439A of the *Corporations Act* and now under s 75-225 of the *Insolvency Practice Rules (Corporations) 2016* (Cth);

- The usual proponents of a DOCA are the directors of a company (other proponents could put forward a DOCA proposal though this would presumably require dialogue with and assistance from the administrators).

It could be argued that a pre-appointment engagement of significant duration and scope – regardless of the actual nature of advice provided or work performed – could constitute a substantial prior involvement which would, in the mind of a creditor, raise doubts that the administrator could provide an independent recommendation or opinion on the matter of any subsequent DOCA proposal.

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So much appears to have been accepted by Byrne J in *Smarter Way v D'Aloia* [2000] VSC 408 at [26]:

> *it is important that the administrator not act or not appear to act merely at the bidding of the appointor to whom, it may be thought, they owe their employment as such. This may be of particular importance where the appointment is made by the directors who may wish to present a deed of company arrangement to the creditors with the support of the administrator's opinion in the s 439A(4) report. In such a case, the creditors are entitled to the independent opinion of the administrator as well as a full and accurate report of the matters specified in that section and in the regulations made under it.*

Another example is the exercise of statutory powers. The real prospect of an administrator exercising the power of sale of a business prior to any second creditors' meeting might give rise to perceived concerns if the appointment of the administrator was preceded by a substantial prior involvement of the same practitioner.

Arguably, 'independence' is equally important as 'impartiality' or 'lack of bias' when it comes to the exercise of one's judgment in invoking broad statutory powers or providing an opinion to creditors.

The *Ten Network* decision: Planning and preparatory work versus 'pre-packs'

If one were to reduce the judgment of O'Callaghan J in *Ten Network* to one key statement of principle, it might be the proposition that as a potential administrator, you can 'pre-plan' a process, but you cannot 'pre-pack' an outcome.

O'Callaghan J's discussion (in obiter) regarding 'UK-style' pre-packs appears to lay down a marker: it is but the latest example of judicial acknowledgment that there is a line which cannot and should not be crossed if an insolvency practitioner wishes to take an appointment as administrator subsequent to a pre-appointment involvement.

In *Ten Network*, planning and preparing for a prospective administration was not found to cause a reasonable apprehension of bias. However, it must be stressed that the Court found that the 'planners and preparers' had not provided professional advice to the Group, its directors or management.

This point bears emphasis: if a practitioner provides any advice to a board which is incidental to pre-planning work and subsequently accepts an appointment, there will be questions as to whether that advice is properly the subject of review by an administrator or liquidator. Where advice is given, the permissibility of pre-appointment planning work will be a very different proposition because the practitioner may have 'crossed the line'. This line may be more difficult to maintain in the context of a small-to-medium size company.

Does 'Safe Harbour' change or affect the general law test (duty) of independence?

It is not apparent that the legislative 'safe harbour' now available to compliant directors under s 588GA of the *Corporations Act* lowers the bar or affects the general law test for actual and

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perceived independence of administrators or liquidators following a pre-appointment involvement. The following points can be made:

- A 'typical' safe harbour engagement would appear to be that of an 'appropriately qualified entity', engaged to advise upon and assist the development of an appropriate 'course of action' that is 'reasonably likely to lead to a better outcome for the company' which is the key to a director's 'safe harbour' protection from liability for insolvent trading: s 588GA(1) of the *Corporations Act*;
- If a court must later determine whether the course of action was reasonably likely to lead to a better outcome, regard may be had to whether the director was 'obtaining advice' from an 'appropriately qualified entity': s 588GA(2). Applying the principles established by the above authorities, it is difficult to see how a 'safe harbour adviser', involved 'knee-deep' in assisting a director with the turnaround or restructuring plan would not suffer from a perceived lack of independence if that adviser purported to accept a subsequent appointment as administrator or liquidator.

The essential point is that the 'Safe Harbour' legislation does not appear to effect any 'legislative override' of general law independence standards established by the authorities detailed above. The Safe Harbour provisions are entirely silent on independence or eligibility for appointment as an administrator or liquidator subsequent to a safe harbour period.

Safe harbour does not provide new scope for an appointment as an administrator or liquidator where such an appointment was previously precluded or prohibited because of the general law or otherwise. Independence standards at law do not appear to have been affected one way or another by 'Safe Harbour'.

How does Chapter 6 of the ARITA Code of Professional Practice compare against the general law? What amendments might be warranted?

It is not unreasonable to state that, generally, Chapter 6 of ARITA's Code ('Independence') reflects the general law tests and standards of independence of liquidators and administrators established by the Courts over the last 25 years.

The key test of independence – ie, that the practitioner must be, *and be seen to be*, independent – is clearly stated in the Code, as is the 'double might' test: see section 6.1 of the Code.

Like any set of professional standards, there are aspects of the Code requirements which may, in some circumstances, set the bar higher than an application of the general law test. An example of this is the 'bright line' test established by the 'two-year rule' in the Code for prior professional relationships. In some circumstances, the 'two-year rule' could impose a 'higher' standard than that which would result from an application of the general law test by a judge in a hypothetical challenge to the practitioner's independence.

Upon the above review of the authorities, aspects of the Code's Chapter on independence appear to require clarification or amendment. For example:

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- The reference in section 6.1.2 to whether a conflict was '*likely*' to arise (to test whether a conflict is a 'mere possibility') could be amended to a more accurate reference to the test established by the authorities – ie, whether there is a 'real as opposed to merely theoretical *possibility* (or *prospect*) of conflict';

- A clearer statement that an individual creditor should not have – nor be seen to have – an influence over an appointee which might impair or compromise the appointee's duty to act in the interests of the company and the creditors as a whole;

- Making further provision – within the exception to the 'two-year rule' for 'Pre-appointment communications and meetings' – for permissible pre-planning and preparation work in contemplation of an appointment, while clearly distinguishing such pre-appointment involvement from impermissible negotiation or conclusion of agreements or outcomes in advance of a planned appointment (in short, clearly distinguishing 'pre-planning' from 'pre-packing');

- Reference to the potential independence issues which arise when remuneration has been paid for pre-appointment work;

- Guidance on indemnities: indemnities serve an important purpose in providing the security for costs that enable liquidators to perform their important role and function but they may also raise potential independence issues.

Proposed amendments to the Code will be subject to broader consultation with State Division Committees and the broader membership.

D. FEEDBACK WELCOME

Again, this paper is intended to form part of a necessary process of healthy debate and consultation on the important issue of practitioner independence and the evolution of ARITA's Code of Professional Practice.

Constructive feedback and alternative perspectives are welcome and can be sent to the ARITA Specialists Team at SpecialistTeam@arita.com.au.

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