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legal update

PRACTITIONER REMUNERATION ON A TIME-COST BASIS

Time for optimism or concern?

The basis on which practitioners seek remuneration for the fees incurred in an external administration has been a matter for debate for almost a century.

The starting position appears to be as set out in *Re Carton Ltd* (1923) 39 TLR 194, one of the earliest reported decisions on the matter. In that matter, the Court fixed a liquidator's remuneration to a percentage of the value of assets available for distribution. Over time, however, and particularly from the 1950s onwards, practitioners, the industry and the Courts all began to favour fixing of remuneration on a time-cost basis.[1]

More recently, a number of decisions have advocated a 'percentage-based' approach of limiting or reducing the remuneration sought by a practitioner to a percentage of the assets recovered during the course of the appointment. The basis of this shift appears to be the concern amongst the judiciary that a time-cost basis of calculating remuneration disregards proportionality and does not provide value to creditors.[2]

Notwithstanding the recent trend towards a proportion of recoveries approach, the Supreme Court of New South Wales' decision in *Idylic Solutions*[3] has given cause for optimism amongst insolvency practitioners. That decision, handed down by Black J, reaffirms that time-cost charging is an appropriate method of calculating remuneration in certain circumstances and where there is sufficient evidence before the Court to justify the remuneration sought.

Practitioners should however continue to proceed with caution. Shortly before the decision in *Idylic Solutions*, Brereton J of the Supreme Court of New South Wales in *In the matter of Dungowan Manly Pty Limited* [2016] NSWSC 1346 reindorsed a proportion of recoveries approach. What lessons are to be learnt then from these two seemingly contrasting cases delivered from the same Court within a matter of weeks?

UNCERTAINTY AROUND REMUNERATION

Before delving into these decisions, it is useful to understand why so much emphasis has been placed on the topic of practitioner remuneration. Putting aside the obvious reasons why practitioner remuneration is close to the hearts of many in the insolvency industry, this topic has been given much attention of late due to the uncertainty surrounding it.

It is well established and accepted that a liquidator is entitled to reasonable remuneration for their services where that remuneration was reasonable and necessary in the circumstances.[4] There are well recognised methods as to how remuneration should be calculated,[5] however, the preferred method, believed in a competitive market to provide the most transparency to creditors, has been the well adopted time-based method.

While there are arguments for and against a time-based approach and a proportionality of recoveries approach, the case law appears clear that there is no one method that fits all external administrations. It appears that each application for remuneration will need to be considered on its merits and on a number of other criteria. The *Idylic Solutions* matter helpfully provides some instructive guidance on those criteria.

FACTS OF IDYLIC SOLUTIONS

The liquidators were appointed to five unregistered managed investment

1 See *Korda, Re Stockford Ltd* [2004] FCA 1682 and *In the matter of Idylic Solutions Pty Ltd as trustee for Super Save Superannuation Fund and others* [2016] NSWSC 1292. **2** See for example *AAA Financial Intelligence Ltd* [2014] NSWSC 1004 and *In the matter of Independent Contractor Services (Aust) Pty Limited ACN 119 186 971 (in liq) (No 2)* [2016] NSWSC 106. **3** *In the matter of Idylic Solutions Pty Ltd as trustee for Super Save Superannuation Fund and others* [2016] NSWSC 1292. **4** Sections 473(10) and 504(2) of the Corporations Act. **5** Time-based, proportion of asset realisations, capped/fixed fees and contingency fee basis.

schemes (Schemes) that operated in contravention of s 601ED(5) of the *Corporations Act 2001* (Cth) and were effectively, in the main, Ponzi schemes, defrauding many Australian and overseas investors.

The liquidators were appointed by the Court on the application of the Australian Securities and Investments Commission (ASIC), following ASIC seizing funds in the accounts held and operated pursuant to the Schemes.

The liquidators were tasked with winding up each of the Schemes, a role which included the commencement of recovery proceedings in New Zealand, tracing transactions in respect of funds paid into or out of accounts operated for the benefit of the Schemes, identifying investors and interested persons in the Schemes and otherwise keeping investors and interested persons informed of the progress of the winding up of the Schemes.

The liquidators sought and were successful in obtaining the Court's approval of the proposed treatment of certain transactions made over the life of the Schemes and the entitlement of investors to any distribution payments in the winding up.

The liquidators then sought the Court's approval for their remuneration, calculated on a time-cost basis. The remuneration sought across the five Schemes was in excess of $540,000.[6] This amount consisted of remuneration for work already performed, and prospective remuneration for work anticipated as being necessary to complete the winding up the Schemes.

The writers instructed the liquidators in respect of the substantive hearing and the remuneration application.

DECISION IN IDYLIC SOLUTIONS

After consideration of the key remuneration decisions since 1923, Black J was of the view that:

> It appears that each application for remuneration will need to be considered on its merits.

- A claim for time-cost remuneration 'should at least be tested by reference to a percentage of realisations'
- While the 'percentage of realisation approach'[7] may not be appropriate in all circumstances, it at least provides a mechanism against which to objectively test whether the remuneration sought on a time-cost basis is proportionate, and
- Practitioners should provide sufficient evidence to allow the Court to consider remuneration claimed on both a time-cost basis and a percentage of recoveries basis.

Black J stated that using a percentage-of-realisations approach to objectively test the proportionality of a time-based remuneration claim will 'identify those cases in which there ought to be real concern in that respect.'

This approach appears consistent with the statements of the Full Federal Court in *Templeton v Australian Securities and Investments Commission* [2015] FCAFC 137; (2015) 108 ACSR 545 that, even if proportionality is not addressed as an 'express factor', the absence of proportionality 'may have forensic significance in determining reasonableness.'[8] That is, a lack of proportionality *may* support a conclusion that the remuneration claimed is excessive.

In support of its application, the liquidators in this case were able to provide evidence detailing:

- The time spent by the liquidators and their employees on each of the Schemes and the value to investors of the liquidators' work (i.e. the successful recovery of monies for the benefit of investors and determining the appropriate distribution of scheme funds to investors).
- Calculations of the remuneration sought in relation to each of the Schemes not only on an hourly basis, but also as a percentage of the pool of funds available in that Scheme and as a percentage of the total funds available across all of the Schemes. When adopting the percentage of realisation approach, the percentage range of remuneration sought for the Schemes, on a stand-alone basis ranged from 7.26 percent to 28 percent. However, given the complexity of the Schemes and the interrelationships between them and comingling of funds, evidence was also provided to demonstrate that the total remuneration sought as a percentage of the total receipts across all the five Schemes was 11 percent.
- The complexity of the work involved.
- The time spent across the different categories of work.
- The allocation of work between staff of differing levels of seniority (demonstrated by the fact that the average hourly rate for all work charged was close to the rate of employees of an intermediate level of seniority).
- The time recording process applied to the work, including the recording of work against the categories of work (e.g. administration, assets, investigations, etc.).
- The internal controls put in place by the liquidators to retain oversight of the time spent on the winding up, including tasking appropriately experienced employees with the role of a liaison between junior and

6 In addition to the Court having approved earlier remuneration in the amount of $237,508 in 2013. **7** See for example *AAA Financial Intelligence Ltd* [2014] NSWSC 1004 and *In the matter of Independent Contractor Services (Aust) Pty Limited ACN 119 186 971 (in liq) (No 2)* [2016] NSWSC 106. **8** At [34].

Remuneration

senior staff to promote coordination of work and regular reviews of work in progress including writing-off time not considered reasonable (presumably this kind of continuous practice presents better to a court than a belated discount made by a liquidator when an application to court is made).
- The time expended and costs incurred in the winding up but not charged by the liquidators.
- The notice given by the liquidators to the investors shortly after their appointment that they were proposing to seek the Court's approval of their remuneration on a time-cost basis (while also explaining the other methods of calculating remuneration).
- The regard paid by the liquidators to the requirements in Parts 14 and 15 of ARITA's Code of Professional Practice which deal with 'necessary and proper' remuneration and disclosure obligations.

On the evidence before the Court, Justice Black was satisfied that the remuneration sought was reasonable and that the requirement of proportionality had been met. His Honour was of the view that the evidence clearly set out the complexity of the winding up, the measures undertaken by the liquidators to ensure that fees were properly incurred and that the work performed was ultimately proportionate to the value created by it.

As such, His Honour approved the liquidators' remuneration without any adjustment, and made further orders approving the liquidators' prospective remuneration to fully wind up the Schemes.

FACTS OF *DUNGOWAN MANLY*

The liquidators in this case were appointed in March 2016 following the resignation and replacement of the former liquidators. The company, Dungowan Manly Pty Limited (in liquidation) was the registered proprietor of a strata title apartment block in Manly, New South Wales.

After creditor approval of remuneration at a creditor's meeting was not forthcoming, the liquidators applied to the Court to have their remuneration fixed in the amount of $42,791 for the period from March 2016 to May 2016. The remuneration sought was in relation to the liquidators' liaising with the shareholders of the company, particularly in relation to a separate judgment obtained by those shareholders against the company.

Part of the new liquidators' task following their appointment was considering the prospects and likelihood of recovery from striking a special levy against shareholders. The liquidators were successful in making further recoveries of $21,000 in this regard.

Before being replaced, the former liquidators successfully realised assets or recoveries in excess of $1.9 million, and paid out distributions in excess of $1.8 million. These recoveries and distributions occurred over a three-and-a-half year period, and the former liquidators received remuneration in the amount of just over $280,000.

At the time of the application of the current liquidators, they held assets of $98,650, representing amounts already recovered at the time of their appointment, together with the recoveries made by them, less legal costs and minor outlays.

At that time, the liquidators were also expecting a further advice from counsel on the prospects of further recoveries through special levies. One of the difficulties for the Court then was whether these efforts were going to be productive or not, and whether the liquidators should be rewarded for a risk taken, where a return may not be generated.

DECISION IN *DUNGOWAN MANLY*

His Honour Justice Brereton was of the opinion that the fairest approach was to fix the remuneration for the entire liquidation, not just the period for which it was claimed, but reserve leave for the liquidators to apply for further remuneration if substantial further work was undertaken, in particular whether any further recoveries were made.

Taking a proportionality of fees approach, His Honour fixed the liquidators remuneration in the sum of $36,000 for the entire liquidation.

In particular, it was noted by Justice Brereton that while the appointment of the new liquidators did require them to review matters which the previous liquidators had already addressed, in terms of the recovery and distribution work done since their appointment, this was less complex then the more recent decisions of *AAA Financial Intelligence Ltd* [2014] NSWSC 1004 and *Contractor Services (Aust) Pty Limited ACN 119 186 971 (in liquidation) (No 2)* [2016] NSWSC 106, in which a percentage of recoveries approach was considered appropriate and applied.

LESSONS TO BE LEARNT

Each of these decisions come at a time when there has been concern in the insolvency industry that the remuneration sought by practitioners would be limited by or reduced to a proportion of the funds available for distribution.

The judiciary's concern stems from the situation where remuneration claimed reflects work that was 'reasonably and properly' undertaken, yet payment of that remuneration would exhaust any returns to creditors.

While Justice Black made a number of observations during the hearing of Idylic Solutions and in obiter in his judgment, as to the inconsistency between the approach adopted by Justice Brereton in *Re AAA Financial*

Intelligence Ltd (No 2) [2014] NSWCA 1270 and the approach adopted by the Full Court in *Templeton v Australian Securities and Investments Commission* [2015] FCAFC 137; (2015) 108 ACSR 545, he wasn't required to make a final determination.

His Honour did however comment that in such circumstances where the remuneration was reasonably incurred that 'fairness, and necessity, require the practitioners be reasonably remunerated'. His Honour did however comment that a full recovery of hourly rates in every case may not be justified.

The decision in *Idylic Solutions* demonstrates that while the requirement of proportionality must be kept in mind when considering the reasonableness of a remuneration charge, this does not mean that time-cost charging is not an appropriate method of calculating remuneration.

In instances where the work required to be undertaken is complex but may not directly result in the recovery of funds for distribution, this does not necessarily mean that the remuneration sought should be reduced or limited to a percentage of the funds available for distribution.

One of the main lessons to be learnt from both these cases, however, is that practitioners are well advised to include in their application for approval of remuneration on a time-cost basis, the degree of information provided in *Idylic Solutions* to give the Court comfort that proportionality and value is being achieved.

Indeed, as was noted by Justice Brereton in *Manly Dungowan*, '[t]o what extent the liquidators' rates and remuneration should be moderated does not admit of mathematical exposition or justification, any more does the fact that they set their own hourly rates.' If the Courts are to have confidence that proportionality and value are achieved, practitioners must provide them with the necessary information to provide that comfort.