WHO WOULD BE AN INSOLVENCY PRACTITIONER IN 2017?

Date: February 2017

INSOL International Electronic Newsletter

By: Ian Dorey, James W. Thompson

2017 is shaping up to be a challenging year for insolvency practitioners in Australia, from the *Insolvency Law Reform Act 2016* (Cth) (**ILRA**), which comes with a raft of reforms to practitioner remuneration and creditors' powers, to the new ASIC 'user pay' funding model which could potentially impact negatively on insolvency practitioners and the Fair Entitlements Guarantee (**FEG**) Recovery Program's pursuit of claims against insolvency practitioners.

In Queensland, insolvency practitioners faced uncertainty regarding potential personal liability for pre-existing environmental harm under the *Environmental Protection (Chain of Responsibility) Amendment Act 2016* (Qld) (**CoRA**), although some much sought comfort seems to be on the cards from the recent guidelines produced by the Queensland government after heavy lobbying.

ILRA

One of the key provisions of the ILRA provides that where a remuneration determination (which provides for the reasonable remuneration of a practitioner) specifies that the practitioner is to be remunerated wholly or partly on a time-cost basis, the ILRA now makes it a requirement that the remuneration is capped. Should a practitioner require further remuneration, they will be required to apply to the creditors, committee of inspection or court for a new determination.

Where no remuneration determination is made, the practitioner is entitled to receive reasonable remuneration. However, that 'reasonable remuneration' is restricted to a maximum of $5,000. This provision of the ILRA broadens the application of the limit of $5,000 which is currently applicable where a remuneration determination cannot be made due to a lack of a quorum at a meeting of creditors. It is therefore vital that practitioners ensure their engagement is governed by a remuneration determination to ensure that they are adequately remunerated.

As we have discussed in previous articles, some other key changes under the ILRA include:

(a) a prohibition on practitioners deriving a profit or advantage from the administration.

Practitioners are already under a common law obligation not to misuse their position for personal gain and are obliged under the Australian Restructuring, Insolvency and Turnaround Association (**ARITA**) Code to maintain independence. However, section 60-20 of the ILRA appears to do more than codify those duties and obligations. It is possible that this section could have the effect of preventing the practitioner from using his or her staff until permission was received from creditors. A failure to do so could create a risk of having the transaction or other

relevant arrangement set aside by the Court as the practitioner may be seen to be "deriving a profit" from the administration.

This seems like an unusual outcome however it could have stifling consequences in the preliminary stages of the external administration process if practitioners are not safely able to employ staff to undertake critical early investigations that maximise return to creditors.

(b) Creditors may request that the practitioner provide information or a report, or produce a document. Such a request can be made by resolution or by an individual creditor.

The finalised Insolvency Practice Rules (Corporations) which were released on 19 December 2016 provide guidance around what may and may not be considered reasonable requests and the requirements for responding to those requests.
It is likely that such requests by creditors, or at least the consideration of those requests, could have the effect of prolonging the administration and incurring greater costs for the practitioner. This would be of concern where the administrator's remuneration is capped as numerous requests from creditors could result in the administrator having to write off significant time to meet their cap or apply for a further remuneration determination.

(c) Creditors may appoint a registered liquidator to review the remuneration of the practitioner and/or a cost or expense incurred by them. Such an appointment can be made by resolution of the creditors or by the company in a members' voluntary winding up.

Where the reviewing liquidator is appointed by resolution of the creditors or by the company in a members' voluntary winding up, the costs of the review will form part of the expenses of the administration of the company. This again raises concerns where the remuneration determination is capped as it is possible that the practitioner will have to bear the costs of the review if the cap is reached or, again, apply for a review of the remuneration determination.

Given the effect of these new creditor powers, it will be interesting to see whether practitioners incorporate contingency fees into their initial report to creditors to account for requests for material and reviews by liquidators. Such practice may be necessary to minimise the risk of a capped remuneration determination being insufficient to cover the practitioner's costs in meeting these additional strains.

(d) Creditors may remove practitioner by resolution of the creditors.

Currently, a liquidator may only be removed by application to the court where there is a "cause shown" due to which it would be in the best interests of the liquidation if the liquidator was removed. A "cause shown" may be misconduct of the liquidator or a conflict of interest. Under the ILRA, a practitioner may be removed merely because the majority of creditors desire a different liquidator.

If removed, a former practitioner may apply to the court for reappointment on the basis that the removal resulted from improper use of one or more of the creditors' powers. In such applications, the court can, in its discretion, make an order determining the remuneration that the former practitioner is entitled to receive and whether it can recoup its costs in bringing the application.

However, the ILRA is silent on what remuneration the former administrator is entitled to receive where no application for reappointment is made. It is also unclear whether the former administrator retains a lien over the funds realised upon their removal.

ASIC USER PAY

Due to commence in the later half of 2017, ASIC is proposing to introduce a new industry funding model to cover its regulatory activities. ASIC has justified the new system, claiming that its costs have significantly outgrown revenues with its transition to a financial services and market regulator.

It is proposed that each of the sectors regulated by ASIC will fund its own regulation. This will mean a "user pay" fee structure for practitioners and currently ASIC is proposing an annual fee of $5,000 (up from $387) and a fee of $550 per appointment (practitioners currently pay $76 to apply for registration as a liquidator of a specific company). These fees are in addition to the new fees under the ILRA which include a $3,500 registration fee and a renewal fee of $1,700 due every three years.

The Treasury Department of the Australian Government has indicated that practitioners will not be able to charge the appointment fee to the administration and is a cost that must be borne by the practitioner.

It is anticipated that these significant increases to ASIC's fees will have a particularly adverse impact on the high volume, low margin market, with the potential for a spike in the number of zombie companies over which practitioners will refuse an appointment due to the minimal profit such appointments offer, once fees are taken into account. It may also lead to a number of practitioners being forced out of the industry.

Further, the new fees also appear to ignore the realities of unfunded court appointed windings up. Practitioners already pay ASIC for unfunded court appointments and disbursements (in addition to fees for searches and advertising Insolvency Notices). The greater majority of such administrations concern companies that have insufficient assets to allow the liquidator to fully recover their costs and disbursements. The new 'user pay' fees will only serve to further reduce the likelihood of any worthwhile return to liquidators and will undoubtedly result in practitioners also refusing to accept Court appointments.

The fees to be charged are expected to provide ASIC with approximately $9 million in revenue from some 700 liquidators. It should be noted that roughly 45% of this revenue amount is spent on enforcement actions, 50% on investigations and surveillance, and only 5% on education.
The fees also prejudice practitioners in that the costs of enforcement and investigative actions are incurred for the benefit of creditors, contributories or company directors. Instead of increasing fees for practitioners, a fairer approach by ASIC could see it potentially charge fees for initiating investigations, increase penalties and increase education so that fewer unnecessary, and ultimately unsuccessful, investigations are requested.

FEG

FEG is part of the Department Of Employment (an Australian Government Department) which provides financial assistance to employees by paying certain unpaid entitlements that have arisen as a result of the liquidation or bankruptcy of their employer. Once a claim is paid, FEG then steps "into the shoes" of the employees as a subrogated creditor and is given priority over other unsecured creditors.

In recent months, FEG has been actively challenging practitioners' decisions in distributing monies realised from assets the subject of circulating security. An example of an asset that is regarded as a "circulating asset" includes cash at bank, debtors and stock.

It is understood that the FEG's letters make demands for payment on the back of claims that the practitioner has paid out its remuneration and general expenses incurred in the administration, in particular ahead of employee entitlements where the unsecured assets of the company are insufficient to cover those entitlements.

Currently, there is no case law which provides definitive authority on the priority of payments in these circumstances. Until clarity is provided by the courts, practitioners may face potential liabilities and demands from FEG.

CORA

On 27 January 2017, the Queensland government released its guideline on issuing 'chain of responsibility' environmental protection orders (**EPO**). The guideline is a welcome addition to the regulatory framework for practitioners given the concerns flowing from CoRA regarding personal liability of practitioners for the environmental obligations of companies.

Under CoRA, an EPO could be served on a practitioner as a person who was, in the preceding two years, in a position to influence the company's compliance with environmental obligations.

However, under the guideline, the Department of Environment and Heritage Protection (**DEHP**) is required to have regard to key principles in determining who can be issued with an EPO, which include:

(a) Culpability

An EPO will only be issued to a related person where that person has participated in avoiding or attempting to avoid environmental obligations.

(b) Reasonable steps

If a related person was culpable but took all reasonable steps to comply with the company's environmental obligations, they will not be liable to be issued with an EPO. What is reasonable will depend on the circumstances.

(c) Extent of actual and expected knowledge

This consideration takes into account that practitioners, at least in the early stages of their appointment, have little knowledge of any wrongdoing.

(d) Financial decision making

This consideration acknowledges that practitioners are required to exercise their financial decision making powers for the benefit of all creditors.

These key principles, and the guideline in general, provide much more certainty around the operation of the CoRA provisions. In particular, the guideline expressly provides that practitioners will not be deemed culpable for pre-existing environmental harm. However, practitioners should still be wary of the possibility of being expected to reasonably identify existing harm and have an obligation to prevent further harm occurring. This may mean that practitioners are required to take steps to stabilise the current environmental situation if there is a risk that it will continue to deteriorate, which could involve considerable costs.

CONCLUSION

We are undoubtedly moving into a challenging period for insolvency practitioners in Australia, from the changes through the ILRA and ASIC's user pay fee structure to FEG's pursuit of payments from practitioners.

It seems likely that the cumulative effect of the matters discussed above will place significant strain on many practitioners and the next twelve months will be a telling time for the industry. It would not be surprising if the number of Australian insolvency practitioners contracts due to the tough new landscape forming on the horizon.

KEY CONTACTS

IAN DOREY
PARTNER

BRISBANE
+61.7.3233.1236
IAN.DOREY@KLGATES.COM

