REFORM AFOOT IN AUSTRALIA – WHERE WILL IT LEAD?

Date: November 2016

INSOL International Electronic Newsletter

By: Ian Dorey, Cameron A. McCormack

This article was first published by INSOL International in November 2016.

There has been plenty of reform on the horizon in Australia and over the past 12-18 months from initiatives to assist in restructuring of viable companies to regulation of insolvency practitioners and practices.

INSOLVENCY REFORMS

The first tranche of reforms contained in the *Insolvency Law Reform Act 2016* (Cth) have already been passed into law. These reforms comprise the Insolvency Practice Schedule (Corporations) and the Insolvency Practice Schedule (Bankruptcy) (**Schedules**), which amend the Corporations and Bankruptcy Acts respectively. However there have been delays in the drafting of the Insolvency Practice Rules (**IPRs**). The IPRs are the "meat on the bones" for this tranche of reform and more specifically regulate the conduct of insolvent administrations and the practitioners who oversee them (**practitioners**).

As a result of industry concerns regarding the period of time available to implement the technology system upgrades and conduct the extensive staff training required to facilitate the mooted changes, the Minister for Revenue & Financial Services, the Hon Kelly O'Dwyer MP, has announced aspects of the reform have been delayed to 1 September 2017 rather than the initial date of 1 March 2017. This will provide the industry with the requisite time to "update their software systems and business processes", according to Minister O'Dwyer.

It should be noted however that Parts 1 & 2 of each Insolvency Practice Schedule – which pertain to the registration and discipline of insolvency practitioners – will commence as scheduled on 1 March 2017.

Draft versions of the IPRs have now been provided for consultation and comment. The public responses were due on 4 November 2016. The IPRs reveal, as anticipated, that headline reform will be implemented in the areas of practitioner appointment and discipline, powers and transparency for creditors, and in remuneration and supervision.

REGISTRATION & DISCIPLINE

The registration and supervision of insolvency practitioners at the regulator level has now been standardised between liquidators (companies) and trustees (bankruptcies). Only registered practitioners may act as a liquidator or trustee, and only a registered liquidator may perform analogous roles in acting as a receiver or administrator (of a company or of a deed of company arrangement).

The application process is now governed by a 'Part 2 committee', comprising three members with the requisite industry expertise from various stakeholders. In considering an application, the committee may require an applicant to attend an interview or sit an exam for determining whether to accept or reject the application.

INFORMING CREDITORS

The Schedules provide that the objects of the reforms include, relevantly, to regulate the conduct of insolvency administrations to give greater control to creditors. To this end, creditors are provided with wide-reaching rights to access information relating to the administration, including access to books maintained by the practitioner and the ability to request information, documents and reports relating to the particular matter.

A request of this nature may be made by a resolution of creditors, or by an individual creditor, and must be complied with unless the request relates to material irrelevant to the administration of the estate, compliance would cause the practitioner to breach their duties, or it is not reasonable to comply.

Under the IPRs a practitioner has 5 business days to provide the material requested, unless they notify the person making the request that the period for compliance has been extended. Notice is also required if the practitioner considers the request unreasonable. This may incorporate circumstances where the practitioner is of the opinion that compliance would substantially prejudice another creditor or a third party (and such prejudice outweighs the benefits of compliance), disclosure would be a breach of confidence, or where there is not sufficient property in the administration to comply with the request. In the latter circumstances, the creditor may agree to bear the cost of complying with the request.

REVIEW OF ADMINISTRATION

The more powerful review powers – from a creditor's perspective – apply to the external administration of companies. The relevant Division sets out the two methods of supervision available in external administrations: inquiry by the Court, or review by a registered liquidator.

The first, which is currently available, is that the Court may inquire into the external administration of a company on its own initiative or on an application by a creditor or officer of the company, and make such orders as it thinks fit – including orders determining any issue arising in the administration, removing a person as external administrator, and orders in relation to losses and remuneration.

Alternatively, a registered liquidator may be appointed by the Court to review any aspects of the external administration.

The major boost to the powers of creditors (which can be exercised without the intervention of the Court) is twofold. First, creditors have the ability to appoint a registered liquidator by resolution to review either the remuneration of the practitioner or a cost or expense incurred by the practitioner. Second, creditors may remove a practitioner and appoint a replacement by resolution at a meeting.

The relevant IPR sets out the powers of a reviewing liquidator, including to engage experts to assist and direct parties to provide information or be interviewed, as well as any power necessary, or reasonably incidental, to carrying out a review. In carrying out a review, the liquidator is obliged to act independently and in the interests of creditors.

Review provisions are also introduced in relation to Bankruptcies. While the Court's powers to inquire are consistent between the types of administration, in respect of personal insolvencies there is no right granted to creditors to appoint a reviewer by resolution. Rather, as an alternative the Inspector-General is granted the power to carry out a review of the remuneration received by the Trustee, either upon his own initiative or on the application of a creditor. The creditors retain the power to remove a Trustee, including the Official Trustee, by resolution.

PROFIT NOT TO BE DERIVED

One area that has generated discussions is the provision stating that the practitioner must not derive profit or advantage from the administration. There are obvious issues with this proposal as all practitioners use their firms' staff to assist in the work associated with a particular insolvency appointment. The Explanatory Memorandum of the IPRs is clear in providing that the practitioner will need to obtain the approval of the creditors for them to use their firm employees as and when it is reasonably practicable.

This issue will no doubt be the subject of further discussions and presumably it has been part of submissions made to the Australian Government. How the Australian Government responds will certainly be of great interest to the profession. It is hoped that sense will prevail.

INVOLVEMENT OF INDUSTRY BODIES

Industry bodies are set to play a greater role in the appointment and discipline of corporate insolvency professionals by virtue of new provisions providing for the involvement of entities such as the Australian Restructuring, Insolvency and Turnaround Association (**ARITA**). In a step towards co-regulation, such bodies will now be represented on newly formed committees tasked with overseeing the admission and discipline of insolvency practitioners. What's more, these industry bodies will be entitled to use information obtained in the course of this dual role to uphold their own professional membership standards, which may be more stringent than the legislative regime.

In order to better regulate the activities of insolvency professionals, entities including ARITA, accountancy societies and state law societies/associations are able to lodge notices with ASIC providing particulars of suspected grounds for suspension or termination of a liquidator's registration.

Further, the Schedule vests with ASIC the power to convene "Part 2 committees" in order to determine, variously, matters concerning registration (including application for registration) or amendment of registration, disciplinary action and suspension of liquidators. A prescribed body may appoint a representative to a Part 2 committee, and for the purposes of these functions that prescribed body is ARITA.

ARITA SUBMISSION

As outlined above, ARITA has become a key stakeholder in the proposed reform by virtue of the increased focus on industry self-regulation in tandem with the overhaul of registration and discipline of insolvency practitioners. It has made submissions on each set of reforms, reflecting the interests of the profession in ensuring the integrity of liquidators – specifically registered liquidators – is upheld. Key submissions made by ARITA include:

- That continuing Professional Development (**CPD**) requirements should be mandatory across the board, not simply for practitioners who are a member of a professional association. In ARITA's submission, 10 hours of verifiable and 30 hours of non-verifiable CPD annually should be a condition of registration of every liquidator, regardless of their status as a member of a professional association.
- That there are problems inherent in the new rules as to deriving 'profit or advantage' where a practitioner uses their firm's employees to assist in the administration. ARITA considers that failure to obtain creditor approval will now likely push the liquidator to resign in order to avoid the alternatives of completing all work in the administration themselves or applying to the Court, both of which are unrealistic in many administrations. The process of replacing a liquidator (potentially without provision of an upfront indemnity) is challenging, and the outgoing liquidator will remain entitled to the AUD5,000 statutory minimum as remuneration.
- Questioning further issues regarding remuneration, including which remuneration may fall within the review period for the purposes of a review by another liquidator – such as in circumstances where more than 12 months' remuneration is billed at once – and the basis on which 'remuneration' is assessed, including on a WIP, incurred or billed basis. Further, ARITA set out that the IPRs fail to contemplate remuneration on any basis beyond hourly rates or commission.

ARITA has also raised concerns with aspects of the obligations imposed by the standards of trustees under Division 42 of the IPR (Bankruptcy). It appears that the position of ARITA is that the standards are not sufficiently flexible to address the range of estate situations faced by Trustees, in which circumstances it may not be practical, for example, to obtain valuations (IPR r 42-45) or make interim distributions (IPR r 42-150).

CONCLUSION

There are clearly still some issues to be sorted and resolved in this piece of reform in Australia.

With the implementation dates fast approaching, a swift and clear response is required from the Australian Government to allow the profession to adjust to the new regime and the bold new world we find ourselves in.

KEY CONTACTS

IAN DOREY
PARTNER
BRISBANE
+61.7.3233.1236
IAN.DOREY@KLGATES.COM