REMUNERATION

10.1. Ministers responsible for Corporations Law and the ASC have received representations from time to time expressing concern in relation to the remuneration of insolvency practitioners. Most commonly, the complaints are of a general nature about the proportion of assets of an insolvent company which are taken out of the pool as a priority payment for an administrator's remuneration and expenses connected with the administration. In many cases, most of the unsecured assets of a company are utilised for this purpose, leaving unsecured creditors with little or no dividend and disillusioned with the system.

10.2. Concerns of this nature were a major impetus for the establishment of this review. The cost of administrations has been a consideration at the forefront of much of the previous discussion in this report, which has examined aspects of the regulatory regime that may tend to discourage practitioners adopting competitive price structures. In this regard, the Working Party considers that its earlier recommendations to open up the profession to non-accountants and to abolish the category of official liquidator should go a substantial way towards promoting competition and reducing the general costs of administrations. This chapter, however, focuses on the actual fee setting mechanisms and the means for reviewing fees.

10.3. Another major issue considered in this chapter is how to remunerate practitioners who conduct administrations of corporations which have little or no assets available to fund the administration.

FEE-SETTING

10.4. As mentioned above, complaints are frequently made that insolvency administrators use up what was left of an insolvent company's assets to cover remuneration and costs, leaving trade creditors with nothing. In one sense, it is unfair to draw the conclusion that remuneration levels of practitioners are unjustified solely on the ground that in many cases the costs of an administration approach or exceed the value of the unsecured assets available to pay them. The fact that a product or service is not affordable to all does not necessarily mean that the price, from an objective viewpoint, is excessive. Nevertheless, the common occurrence of unsecured creditors seeing most, or all, of the available assets used to cover the expenses and remuneration of practitioners has led to a perception in some quarters that the insolvency industry generates more benefits for itself than for the creditors it serves.

10.5. More specific complaints include liquidators charging for work that creditors consider unnecessary and the charging of fees without regard to the relative complexity or difficulty of a particular liquidation.

Features of the Current System

10.6. Currently:

- the Corporations Law does not prescribe remuneration levels, but encourages remuneration to be agreed between the liquidator or administrator and the creditors or members;
- the predominant method for remuneration is based on practitioners charging an hourly rate for time spent working on the administration;
- the courts have a general supervisory role in settling disputes over remuneration, or setting remuneration when it is not practicable for agreement to be reached;
- remuneration is recoverable from assets of the company in priority to other unsecured debts and obligations;
- the IPAA issues a guide to hourly rates which has become a standard which is accepted as reasonable by courts and many creditors; and
- the IPAA guide effectively has a built-in allowance to cover administering assetless companies.

10.7. In the report of the former Trade Practices Commission, concern was expressed about features of the current system of remuneration for insolvency practitioners which have the potential to affect the impartiality and efficiency of insolvency administrations.[1]

IPAA Guide

10.8. The Guide to Hourly Rates issued by the IPAA for remuneration of insolvency practitioners ('the Guide') lists a series of hourly rates in relation to various categories of person who are likely to work on an insolvency administration, from office juniors through to the principal appointee.

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1 Trade Practices Commission, *Study of the Professions, Final report—July 1992, Accountancy*, pp. 74–82.

10.9. The Guide was recently given legislative recognition in the context of personal insolvency. Where the creditors of a bankrupt estate fail to fix the trustee's remuneration, the remuneration is calculated in accordance with the Guide.[2] There is no legislative basis for use of the Guide in the context of corporate insolvency but, as mentioned above, it is widely accepted by the courts and creditors as being a reasonable standard to use.

10.10. The rates set out in the Guide are 'cost-based'. That is, they are calculated by reference to the costs of conducting administrations in the relevant location, with an allowance for a reasonable profit margin. The rates are calculated by consultants employed by the IPAA. They are reviewed by the ASC on an annual basis and a major review, funded by the IPAA, is conducted triennially.

Consideration by Other Review Bodies

10.11. The use of the Guide was considered by the former Trade Practices Commission and the Australian Law Reform Commission in separate reports.

Trade Practices Commission

10.12. Arrangements or understandings between suppliers regarding prices to be charged for services may fall within the ambit of the general prohibitions on restrictive trade practices set out in Part IV of the *Trade Practices Act 1974*.[3] However, there are provisions in that legislation which allow the regulatory authority (formerly the Trade Practices Commission, now the Australian Competition & Consumer Commission) to authorise any activity which otherwise is, or might be, a restrictive trade practice under the Act.[4] The regulatory authority is required to assess any application for an authorisation in accordance with public benefit criteria. The former Trade Practices Commission considered a number of applications from trade associations who sought an authorisation for issuing price recommendations. In 1978, a statement of general principles was issued by the Commission providing guidance as to the exercise of this power in those circumstances. The principles stated, in part, that:

> '(b)...the members may include all or most of the firms in the relevant market, which makes anti-competitive consequences of price recommendations more probable; the members may have a common interest in keeping at or about the recommended prices, not so much because this is a level which reflects their costs, but because it is likely to become market level or higher than the market level would be in more competitive conditions.

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2 Section 162(4), *Bankruptcy Act 1966* and Regulation 8.08, Bankruptcy Regulations.

3 See, in particular, sections 45–45A, *Trade Practices Act 1974*.

4 See Part VII, *Trade Practices Act 1974*.

(c) An extreme case of (b) may be where market entry is limited to operation of law, for example by licensing provisions...'[5]

10.13. In light of the above, it is not surprising that, in its 1992 report on the accounting profession, the former Trade Practices Commission gave detailed consideration to the use of the Guide.[6] The Commission expressed serious concerns about the Guide and stated that, in the context of the restricted access to the insolvency market, it had become a powerful restriction on competitive behaviour. The information available to the Commission at the time of the report suggested that the scale of fees then in place had operated as the norm and was applied in the large majority of cases, thereby all but excluding the element of price competition.

10.14. The Commission considered the following public benefit arguments in favour of issuing a guide for hourly rates:

- in the absence of some guide, creditors and, more particularly, the courts, would find it extremely difficult to make any kind of judgement about the appropriateness of the fees charged or proposed to be charged (the 'market information' argument); and

- the rates in the Guide are actually lower than the rates generally charged for other accounting services, which suggests that the Guide operates as a check on fee levels and, in its absence, prices would rise (the 'price check' argument).

10.15. The Commission dismissed the market information argument in relation to creditors because it considered that larger creditors would be well aware of the market rates and smaller creditors would usually use a solicitor as an intermediary who should also be well-informed. As to the position of the courts, the Commission suggested that in a more competitive market there would probably not be a call for external review of remuneration rates. To the extent that there was, the Commission suggested it should be done by the ASC based on surveys of actual fees charged, rather than by the court using a cost-based estimate. Since the calculations in the Guide are based on 'average' costs (with an allowance for assetless administrations), plus a margin for reasonable profit, they cannot properly reflect the cost structures of individual firms. Further, the published rates do not attempt to address the amount of time which would be reasonable to spend on any particular job and therefore are likely to encourage inefficient work practices. Accordingly, in the Commission's view, the published rates are of dubious value as a guide to users.

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5 Price Recommendations to Members by Trade Associations of Small Businesses (1978) TPRS 403.147.

6 Trade Practices Commission, *Study of the Professions, Final report—July 1992, Accountancy*, pp. 74–83.

10.16. The Commission rejected the 'price check' argument on the basis that the Guide was customarily used even for administrations not ordered by the court. The Commission's view was that the widespread use of the Guide suggested that it provided 'a convenient mechanism to ensure relatively high returns for the work involved'.[7]

10.17. The Commission concluded that the scale is anti-competitive and should either be discontinued altogether or replaced with a survey of actual rates charged. If it is felt that public interest arguments continued to justify the use of the Guide, the IPAA should apply for an appropriate authorisation under the *Trade Practices Act* for consideration through the procedures provided for under that Act. Furthermore, serious consideration should also be given to whether the courts should continue to have a role in determining remuneration levels.[8]

Australian Law Reform Commission

10.18. In the Harmer Report of 1988, the ALRC gave some consideration to the need for remuneration scales.[9] The ALRC considered that, given the largely public nature of insolvency practice, it is desirable that there is a facility to set scales of remuneration. Although the rates set by the IPAA were generally accepted as providing an objective standard which was widely acknowledged by creditors and the courts, they did not have universal application and were not binding.

10.19. The ALRC recommended that the regulatory authority in the form of the proposed new statutory board should have the power to determine and set maximum remuneration scales for practitioners and review those maximum levels at appropriate times. The maximum rates set by the statutory board should be given legislative recognition.[10]

Method of Calculation

10.20. Another aspect of the Guide which received comment in submissions to the Working Party was the general lack of understanding as to the basis on which the fees are calculated, particularly in relation to overheads. Although it is well known by practitioners that overheads are included in the calculation, together with an allowance

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7 Trade Practices Commission, *Study of the Professions, Final report—July 1992, Accountancy*, p. 81.

8 Trade Practices Commission, *Study of the Professions, Final report—July 1992, Accountancy*, p. 82.

9 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraphs 946-947.

10 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraphs 947.

for unremunerative work and a margin for profit, precisely which overheads are included are not expressly identified. This could lead to some practitioners effectively charging twice for the same costs by including them in the account as disbursements when they have already been taken into account in the hourly rates. Others may not be recovering all they are entitled to because they have assumed some overheads are covered in the hourly rates when in fact they are not.

10.21. Possibly of more concern is the allowance in the Guide's hourly rates for the costs of administering assetless administrations. Arguably this is not an appropriate means of dealing with the costs of these administrations because not all practitioners engage in the unremunerative work. The issue of remuneration for assetless administrations is a major issue which is discussed further below.

Comment

10.22. Issues relating to the IPAA Guide were raised in the Working Party's discussion paper. Many comments were received by the Working Party on this issue and the general feeling was that the Guide was of value. Comments were made that:

- the Guide provides an established benchmark which assists in orderly fee negotiation and provides an industry guide for creditors and courts to use when considering fees;

- in the absence of a benchmark, there would be arguments over remuneration in nearly every case, which could result in increased costs and delays;

- criticisms of the Guide are misguided because:

  - it is not compulsory and fee levels are sometimes set below the published rates;

  - the fees in the Guide are set independently and reviewed by the ASC;

  - competition is strong, particularly in relation to receiverships, despite the existence of the Guide;

  - the Guide does not prevent other types of fee setting mechanisms like percentage or contingency fees being used occasionally, but creditors generally are not in favour of them.

10.23 The Working Party considers that, although the rates in the Guide have been the subject of much attention and controversy, the significance of the level of the hourly rates in the overall costs of administrations is debatable. Complaints of excessive remuneration levels are rarely based solely on the high hourly charge-out rate. Rather, the total cost of the administration compared to the assets recovered is the

real issue. The role of the Guide should be addressed in the context of a wider debate regarding fee setting mechanisms. Those issues are considered below.

Time-Costing, Fixed Fees and Commissions

10.24. There are three main mechanisms commonly used for pricing services: time-costing, fixed fees and commissions. In this part, the relative merits of each in the insolvency context are discussed.

Which System is the Fairest?

10.25. In Australia, the fee-setting mechanisms for insolvency practitioners have traditionally been time-based, although there is no legal requirement in that regard. Charging by reference to the amount of time spent on matters is also the traditional method of fee-setting for legal and accounting work in Australia.

10.26. The main reason time-costing has become the norm is basically the same in all three cases. Unlike many other service industries, there is a high level of uncertainty at the outset of jobs as to how complex and resource-intensive a piece of work may be until at least some preliminary work has been carried out and, even then, there is the ever–present prospect of new problems arising during the course of the administration. Quoting a fixed price for an uncertain level of work is risky for the service provider and, as a result, fees are likely to be higher, in the majority of cases, than they would be if a time-costing method was used. This is because service providers offering fixed fees must make a larger profit on the majority of their jobs than competitors who charge on a time basis in order to compensate for the occasional job when, inevitably, they make a large loss because it costs more to perform than expected.

10.27. By contrast, where there is a relatively high degree of certainty involved regarding the amount of work to be performed and the risks of making a loss are low, fixed fees become the norm, even in fields otherwise dominated by time costing. For example, this can be seen in relation to accountants' fees for preparing salary and wage earners' taxation returns and lawyers' fees for residential conveyancing.[11]

10.28. There are also some examples in the legal and accounting areas where, despite relatively high levels of uncertainty about the work required, fixed fees are sometimes used. For some jobs at the upper end of the spectrum, it has become common practice for consumers to put the jobs out for competitive tender. This can be seen in, for example, legal work for large contracts or privatisations and, in the accounting field, audit work for large companies. The process of making estimates and preparing tender

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11 Fixed fees tend to be used for such work irrespective of whether there is competition from service providers outside of the relevant professions.

documentation for such work is costly, but practitioners are prepared to participate in the process and, in some instances, risk quoting a fixed fee (sometimes subject to qualifications), because of the profit they stand to make if the work required does not exceed their estimates. To date, however, the tender process has usually only been used in relation to very large projects (or large bundles of smaller projects) because the high costs associated with this process are not warranted for small or medium sized jobs.

10.29. Tenders are virtually unknown in insolvency practice and it is unlikely that they would be well-suited to insolvency work in the vast majority of cases for two reasons. First, in order for bidders to make meaningful estimates of costs, a reasonably detailed description of the work to be performed would be required in advance. Secondly, it would involve long lead times which are rarely, if ever, practicable in the insolvency context.

10.30. The final method of charging which could be used for insolvency services is a commission system. This involves the practitioner being remunerated on the basis of a percentage of the assets recovered for the benefit of creditors.

10.31. From the creditors' perspective, commissions offer the advantage that at least a proportion (and probably most) of the assets recovered will be distributed to them. However, from the practitioner's viewpoint, commissions are an uncertain method of calculating remuneration because the amount of work involved in an administration is not necessarily proportional to the value of the assets available for distribution. In many cases, practitioners may require a fairly high percentage rate to compensate for those administrations in which the percentage-based remuneration does not cover their costs. Nevertheless, the commission-based system is widely used in the United Kingdom and the United States.[12] In the United States there is a maximum percentage limit, while in the United Kingdom there are facilities to increase or decrease the remuneration payable pursuant to the commission-based system. For obvious reasons it is not practicable to use the commission system in cases of assetless administrations, so a flat fee is used in those circumstances in the United States and time-based charging in the United Kingdom.

10.32. It is difficult to make any general remarks about whether a commission-based fee calculation would be less costly than a time-based or fixed-fee based one. Clearly it depends on the percentage figure arrived at, the value of the assets available for distribution and the work conducted in each particular case.

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12 See Trade Practices Commission, *Study of the Professions, Final report—July 1992, Accountancy*, pp. 143–149.

Influence of the Fee-setting Mechanism

10.33. The above discussion considered different remuneration systems on the underlying assumption that the work performed by practitioners is the same, irrespective of the fee setting system used. In practice, however, this would probably not be so. It is possible that the fee setting mechanisms used could influence practitioners in the way they conduct administrations.

Time Costing

10.34. Practitioners working on a time-based remuneration system have an incentive to maximise the time that they spend working on an administration, subject to their obligations to account for all time spent. In cases where assets are available, practitioners are likely to conduct a very thorough administration. Although this has some benefits, many complaints have been received along the lines that practitioners working on a time-costing basis have increased the remuneration they receive by engaging in practices such as:

- spending time on speculative investigations and recovery possibilities which would not be contemplated if funds were more limited;
- assigning either too many or too highly qualified staff to tasks; and
- taking too long to perform tasks.

10.35. Even relatively large reductions in the hourly charge-out rates can be easily negated by the practices mentioned if they are left unchecked. Competition which results in lower hourly charge-out rates is therefore not a complete solution to unreasonably high fee levels.

10.36. One means of addressing the difficulties that arise with time-based charges is by establishing an efficient and effective procedure for reviewing fees. This is discussed further below.[13] Using a method of fee-setting other than time-based is another option and that is discussed immediately below.

Fixed Fees and Capping

10.37. A fixed fee regime may encourage practitioners to spend a minimal amount of time on an administration. Arguably, this is a considerable advantage over the time-cost based system because it is likely to eliminate inefficient work practices and creditors would not pay for any unnecessary work. However, in some cases fixed fees could work to the detriment of creditors and the wider public interest. This is because

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13 See paragraphs commencing at 10.65.

practitioners working on this basis would be reluctant to spend any time following up all but the most obvious possibilities for recovery of assets. Furthermore, practitioners may be tempted not to explore evidence suggesting there may have been wrongdoing because they would have no pecuniary interest in spending time reporting on it.[14]

10.38. Another approach would be to use a time-based system but also quote a maximum level or 'cap' so that the creditors have advance notice of the maximum amount of fees that will be deducted. Although this practice would not be suitable for all administrations, it could be utilised in cases where there is a reasonable level of certainty about the work involved. The Working Party envisages that there would be a facility to revise the cap in appropriate cases, for example, where unexpected work arises, by seeking approval of the creditors. Even though this does not provide creditors with a guaranteed maximum fee level at the beginning of the administration, requiring the practitioner to justify a revision of the capping level to creditors provides a mechanism of accountability that is not present with an 'open-ended' time based method.

10.39. The Working Party notes that the explanatory material to the latest version of the IPAA Guide (a copy if which is at Schedule 3) contains the following paragraph:

> 'The resolution for remuneration should include a specified amount and where remuneration is approved prospectively an upper limit must be included in the resolution of creditors or Committee of Inspection. If an amount is not specified or the amount specified is exceeded, it will be necessary for practitioners to convene a further meeting in order to seek approval for a specified amount or for the additional amount, as applicable.'

Commissions

10.40. A commission-based system is a method of fee setting which closely aligns the practitioner's pecuniary interest with that of the creditors because the practitioner has an incentive to maximise the return to creditors. However, commission-based fees have been criticised because they encourage practitioners to focus on a quick and easy realisation of assets and the maximum return that can be obtained for a minimum cost in terms of work performed. Practitioners may be discouraged from looking at alternatives which require more work but, in the longer term, could be more beneficial to creditors, employees and the wider economy. Other concerns are that, like fixed fees, there is little incentive to do any sort of work which does not directly increase the return to creditors, such as reporting on possible misfeasance by company officers.

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14 The extent to which administrators should be required to engage in activities which do not directly benefit creditors, but rather the wider public interest, is discussed further below (see paragraphs commencing at 10.45).

Role of Creditors in Fee Setting

10.41. A consistent theme in many of the submissions to the Working Party concerning the remuneration mechanisms was that the solution to many of the difficulties does not lie in wholesale changes to the existing framework. Rather, educating creditors about, and encouraging them to participate in, the procedures that are already in place was seen as the preferable approach. Often difficulties arise because creditors who appear unlikely to receive a dividend are unwilling to take an interest in any other aspect of the administration, even where they are aware of their rights.

10.42 The ASC suggested that one approach to this problem could be to amend the Corporations Regulations dealing with meetings for approval of liquidators' remuneration. If creditors took a greater interest in, and responsibility for, the negotiation of remuneration, it may encourage liquidators to charge by some means other than on the basis of the IPAA Guide.

10.43 The Law Council of Australia favours a requirement for practitioners to provide advance notice to creditors of the proposed level of their remuneration and, when approval of fees is being sought, greater detail as to what work has been carried out in arriving at those fees.

10.44. A further suggestion was that legislation should require that a practitioner obtain creditors' approval for the fee-setting mechanism, as well as obtaining approval from the creditors for each lump sum drawing. This proposal may present problems in cases where creditors do not take an interest in the administrations and so are not present at meetings. To combat this difficulty, it was proposed that if a meeting of creditors was called to approve fees and a quorum was not available at that meeting or there was an adjournment of that meeting, the practitioner should be able to draw fees without having to approach the court.

Reporting Obligations of Liquidators

10.45. One aspect of the role of insolvency practitioners which must be taken into account when considering remuneration and fee-setting mechanisms is the responsibilities they have in relation to matters which are not directed at maximising returns to creditors. There are two elements to this wider responsibility:

- the obligations imposed on liquidators to furnish reports to the regulatory authority, particularly in relation to possible misfeasance by company officers, (dealt with immediately below); and

- the winding up of assetless corporations, which is dealt with later in this chapter.

10.46. A liquidator is required to lodge certain accounts, reports and statements with the ASC.[15] In particular, a liquidator must lodge a preliminary report (usually within two months of appointment) which states whether, in his or her opinion:

> 'further inquiry is desirable with respect to a matter relating to the promotion, formation or insolvency of the company or the conduct of the business of the company.'[16]

10.47. Possibly of more significance, in terms of the resources required, is the liquidator's continuing obligation to report to the ASC suspected breaches of the Corporations Law, misapplication of funds, negligence, breach of duty or breach of trust by past or present company officers or members.[17] Further reports may also be lodged specifying any matter which the liquidator thinks is desirable to bring to the attention of the ASC.[18] The court may direct a liquidator to lodge such a report if, during the course of a winding up, it suspects that some misfeasance on the part of present or past officers or members may have occurred.[19] Following the provision of such a report, the liquidator must:

> 'furnish the [ASC] with such information, and give to it such access to and facilities for inspecting and taking copies of any documents, as the [ASC] requires.'[20]

10.48. Preparing reports and otherwise assisting the regulatory authority in relation to possible misfeasance by company officers and others does not usually result in a greater return to creditors. In fact, depending on the extent of the work required and the method of fee-setting being used, it can result in either a reduction in return to creditors in that particular administration, or a significant loss to the practitioner concerned which eventually will be reflected in higher costs of other services performed. It has been suggested that this is not a satisfactory situation. One submission to the Working Party suggested that, for the sake of reducing costs, the 'public duty' aspects of the liquidator's role should be eliminated so the liquidator's only concern is the speedy realisation of assets and maximising returns to creditors.

10.49. When the issue of the extent of the liquidator's investigatory and reporting functions was canvassed in the 1988 Harmer Report,[21] the ALRC concluded that there

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15 Sections 476, 509, 533, 539, Corporations Law.

16 Paragraph 476(d), Corporations Law.

17 Section 533, Corporations Law.

18 Subsection 533(2), Corporations Law.

19 Subsection 533(3), Corporations Law.

20 Paragraph 533(1)(e), Corporations Law.

21 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraphs 952-954.

should be no change to the existing duties. Those duties have not substantially changed since then. The ALRC considered that the public duties of liquidators regarding reporting on possible misfeasance are inextricably bound up with their duty to creditors to make due inquiries into possible claims against directors and other officers which may result in the recovery of assets for the benefit of creditors. It was considered more efficient for the liquidator to conduct preliminary investigations and report to the regulatory authority in the course of their other duties, rather than to split the functions and, for example, have a public official conduct inquiries.

10.50. The Working Party agrees that having preliminary investigative and reporting functions performed by public officials would be less efficient than having it done by the liquidator in the course of the administration. However, there is a threshold issue which was not canvassed by the ALRC regarding whether the function is really necessary. This question arises particularly because some reports made by liquidators may not always be followed up by the ASC due to resource constraints or other reasons.

10.51. In this regard, the Working Party considers that, despite the fact that some reports may not always be acted upon by the regulatory authority, information uncovered in the course of a liquidation is an important means of identifying corporate misconduct by company officers and others. A liquidation is one of the key occasions in the life of many companies when a party other than the directors has an opportunity to examine the operations of the company as a whole and identify possible misfeasance. Even if every report is not acted upon immediately, the fact that it has been lodged could be of value if subsequent reports are made regarding dubious conduct by the same persons.[22] This is particularly important in relation to companies which have become insolvent and caused creditors to lose substantial sums.

10.52. Recent proposals aimed at reducing the incidence of the so-called 'phoenix company' phenomenon[23] rely, to some extent, on information provided to the ASC during the course of a liquidation as a basis for disqualification of persons from directing other companies. There is no obvious alternative to liquidators' reports for obtaining such information.

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22 For example, involvement in the management of two or more failed companies may give rise to grounds for disqualification of the persons concerned. Sections 599 and 600 of the Corporations Law give the court and the ASC certain powers to disqualify persons who take part in the management of two or more companies which have failed within a seven year period.

23 This is the situation where a company which goes out of business owing creditors large sums of money 'rises from the ashes' in the form of a new company to conduct a similar business under the same or similar management, sometimes using a substantially similar company name.

10.53. If reports of corporate misconduct were not made during the liquidation phase, there would be a gap in the regulatory framework that could potentially result in a significant increase in the frequency of misfeasance by company officers which go undetected and unhindered. Although it might be argued that this conduct is only harmful to the creditors of the company concerned, there is a wider public interest in maintaining high standards of corporate conduct for the benefit of creditors, investors and the economy as a whole.

10.54. For these reasons, the Working Party considers that removing the 'public duty' obligations of liquidators is not a desirable option.

10.55. In light of the wider interest in a liquidator's work, a case could be made that the burden of that work does not, at present, fall equitably. Arguably, that the cost of work performed in the public interest should be at the public's expense. One way of achieving this would be to require the ASC to pay liquidators for their reports or, at least, for any further inquiries that the ASC requests the liquidator to make. The funds for such a scheme could either be allocated out of consolidated revenue or be raised by the ASC by, for example, increasing fees for company annual returns.

10.56 As mentioned above, where time-based fees are used, the cost of the practitioner performing his or her duties is currently borne by the unsecured creditors, since the practitioner will be remunerated at the usual hourly rate for the time spent carrying out reporting functions following the discovery of a possible breach. In fact, the practitioner may profit from performing the work. If fixed fees or commission-based methods are used, the practitioner would bear the cost directly to the extent it has not been allowed for in the agreed remuneration, but indirectly the cost would be passed on to creditors in other administrations because the practitioner would need to compensate for any losses suffered by charging higher rates.

10.57. Consequently, the persons who bear the cost of the 'public duties' of liquidators are essentially the persons who bear the loss caused by possible misfeasance in that they are often creditors of insolvent corporations. On an individual level, this appears unfair, because the parties concerned suffer one loss on top of another. No doubt in many instances unsecured creditors are innocent victims of the mismanagement, misfortune or otherwise of an insolvent corporation and they have little, if anything, to gain personally out of actions taken against possible wrongdoers except those resulting in recovery of assets. However, from another perspective, when viewed as a whole, creditors of failed corporations comprise, for the most part, persons who unsuccessfully risked advancing credit to an entity with limited liability in order to profit from the transaction themselves. Often those persons would have had the opportunity to deal with the corporation on a different basis or refuse to deal with it at all. Arguably, that class of persons has the most to gain from maintaining high standards of corporate conduct and it is therefore appropriate that they, as a class, contribute more than other creditors or taxpayers generally towards the costs of the regulatory system. This rationale does not apply to the Australian Taxation Office and

other authorities who become creditors by operation of law. However, in the case of those bodies, the burden is ultimately shifted to the wider community.

10.58. The Working Party acknowledges that the current situation is not perfect and the above justification would be cold comfort to creditors who, directly or indirectly, must fund reports and investigations which provide them with no direct benefit. However, the options of having a public official perform the role, having liquidators perform it but funded by the government, or eliminating the reporting and investigatory requirements altogether, are not, in the view of the Working Party, desirable alternatives at present.

10.59. However, it may be possible to clarify and streamline the reporting requirements with a view to lowering costs and reducing unnecessary work. It should be noted that, although the Corporations Law requires a very wide range of possible misfeasance to be reported, it is only required if the matter comes to the practitioner's attention in the course of a winding up. Practitioners are not required to take a pro-active approach to the investigative and reporting function, although some submissions to the Working Party indicate that there may be a perception in some quarters that this is the case. Furthermore, practitioners may spend too much time gathering material in relation to matters which the ASC considers do not warrant further investigation. Alternatively, some practitioners may provide too cursory a description of the conduct in question, which requires subsequent reporting to clarify matters.

10.60. To address these issues, the Working Party recommends that the ASC should work together with the professional bodies to develop guidelines that assist practitioners identify the types of possible misfeasance on which the ASC is focusing from time to time and provide some indication of the level of detail that the ASC expects in reports.

10.61. Apart from playing a role in reducing costs, clarifying practitioners' responsibilities may also be beneficial from another perspective. At present, there is a financial incentive for practitioners to perform the 'public duty' aspect of their duties because of time-based fees. However, if commissions and fixed-fees become more common, there will be a disincentive to do this work. It would therefore be to the advantage of the ASC and the public to ensure that practitioners have a sound understanding of the extent of their responsibilities in this regard.

Conclusion

10.62. The Working Party does not consider that criticisms of commissions and fixed fees based on fears that their introduction would increase costs are well founded. The market should be allowed to determine the most cost-effective fee systems. However,

the Working Party sympathises with the view that the public interest is not necessarily best served by minimising the cost of administrations at the expense of quality.

10.63. There is currently no legal impediment to using a fee setting mechanism other than the time-based system. In fact, the Corporations Law clearly contemplates that remuneration may be calculated on a percentage basis.[24] The Working Party considers that the IPAA Guide may tend to discourage relevant parties from exploring different and more flexible means of calculating remuneration. However, the preferable solution is not necessarily abolishing the Guide, which provides a benchmark against which the reasonableness of fees may be assessed. Although the Guide could be modified so that its utility as a benchmark is enhanced, the Working Party considers that the key measure should be educating creditors on their rights, powers and possible options with regard to fee setting.

10.64. The Working Party recommends that:

- the ASC, in consultation with the relevant professional bodies, should consider appropriate means to educate creditors and practitioners about the different methods of fee setting available and the rights which creditors have with regard to establishing fees so as to encourage greater involvement by creditors in fee setting;
- the notices to creditors of a meeting to determine fees of insolvency practitioners should set out a proposal for remuneration as well as a summary of the creditors' rights to vary the proposal;
- where time-based methods are used, the practice of 'capping' fees should continue to be encouraged; and
- the method of calculating the IPAA Guide, particularly in connection with overheads and disbursements, should be better explained.

REVIEW OF FEES

10.65. No matter which system of remuneration is used it would be desirable to have some kind of review process in relation to the remuneration payable. However, this will probably be more relevant where time-based systems are used.

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24 Subsection 473(1).

Current Position

10.66. There are two existing means by which liquidator's fees may be challenged; review by the court, and review by the professional bodies.

Review by the Court

10.67. Remuneration of provisional liquidators is set by the court and there are no provisions in the Corporations Law dealing with review.[25]

10.68. In court ordered liquidations, remuneration is set initially by the committee of inspection and, failing that, by a resolution of creditors, or finally by the court itself.[26] Where remuneration is set by a committee of inspection, it is open to:

- a member or members representing at least 10 per cent of the issued share capital;
- a creditor or creditors with at least 10% of the total debts; or
- the ASC,

to apply to the court to have the remuneration varied.[27] If the remuneration is set by a meeting of creditors, the liquidator or member(s) representing at least 10 per cent of the issued share capital may apply to the court for review.[28] The court may, upon hearing the application, increase, decrease or confirm the remuneration set by the creditors or the committee of inspection.

10.69. In a voluntary winding up, the liquidator's remuneration is set at first instance by the committee of inspection or, failing that, by resolution of creditors.[29] The liquidator and any creditor or member may apply to the court for review of the remuneration, and the court's decision is expressly stated to be final and conclusive.[30]

10.70. Remuneration of administrators and deed administrators is set by resolution of the creditors or, failing that, by the court.[31] If remuneration is fixed by resolution of

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25 Subsection 473(2), Corporations Law.
26 Subsection 473(3), Corporations Law.
27 Subsection 473(5), Corporations Law.
28 Subsection 473(6), Corporations Law.
29 Subsection 499(3), Corporations Law.
30 Section 504, Corporations Law.
31 Subsection 449E(1), Corporations Law.

creditors, the court has power to review the remuneration on the application of the administrator or an officer, member or creditor of the company.[32]

10.71. Remuneration of privately appointed receivers is determined by negotiation between the receiver and the appointing party. However, the court retains wide powers to fix and vary remuneration of receivers, sometimes even retrospectively, especially where the corporation concerned enters into another kind of external administration.[33] Applications for orders to fix remuneration or vary an existing order may be made by a liquidator, administrator, deed administrator, or the ASC.[34] The receiver may apply to the court to vary an existing remuneration order.[35] There are no similar powers in relation to non-receiver controllers.

Review by the Professional Bodies

10.72. The joint statement of insolvency standards issued by the ASCPA and the ICAA[36] provides that members of those organisations must be remunerated in accordance with rules of conduct laid down by each organisation.[37] The first of those rules states that fees must be:

> 'a fair reflection of the value of the work performed for the client, taking into account:
>
> (a) the skill and knowledge required for the type of work involved;
>
> (b) the level of training and experience of the persons necessarily engaged on the work;
>
> (c) the time necessarily occupied by each person engaged on the work; and
>
> (d) the degree of responsibility that the work entails.'

10.73. Persons who feel that the remuneration charged by members of those organisations is unfair can complain directly to them or through the IPAA if the person is also a member of that body. The professional bodies can arrange for an informal mediation to take place with a view to reaching a settlement. In extreme cases of overcharging, the complaint can lead to disciplinary proceedings, on the basis that the

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32 Subsection 439E(2), Corporations Law.

33 Section 425, Corporations Law.

34 Subsection 425(5), Corporations Law.

35 Subsection 425(6), Corporations Law.

36 APS 7 clause 24.

37 ICAA Rules of ethical conduct REC1/ASCPA Code of professional conduct, statement F5.

member has breached the rules of conduct.[38] However, whether a breach has occurred is often a matter of opinion and ruling on such matters can be very difficult. Although the sanctions available through the disciplinary process do not extend to ordering practitioners to refund or forfeit fees, the threat of such proceedings and the prospect of disciplinary sanctions may encourage practitioners to settle the matter through mediation if they think an adverse finding is likely to be made.

Commentary on the Review Mechanisms

10.74. The Working Party considers that the existing arrangements for challenging a liquidator's fees, namely review by the court, and the ability to lodge a complaint with the practitioner's professional body or with the ASC, are adequate. Lack of creditor awareness about the available review mechanisms is likely to be a major contributor to the infrequent use of the existing procedures. This could be addressed in the course of educating creditors generally about their role in the fee setting process.

10.75. The Working Party also considers that there would be advantages in shifting the formal court-based system to one involving review by experts. This type of approach is used in connection with the review of fees charged by bankruptcy trustees.[39] One way of introducing this system would be to allow the ASC to refer matters involving allegations of overcharging to the CALDB. The CALDB could be given powers to tax bills of costs and order refunds of fees where overcharging has been proved. It would be desirable for the CALDB to consult with representatives of the professional bodies and, in particular, the IPAA, in relation to these matters. The IPAA, as a peer review body, would be able to provide expert evidence regarding the amount of work that would reasonably be required to perform any given administration.

10.76. Whether or not changes are made to the structure of the formal review system, the Working Party considers that it should be extended so it is available in respect of any type of corporate insolvency administration.

10.77. The Working Party envisages that the formal fee review procedures would only be applied in extreme cases due to the expenses involved. The informal mediation system currently operated by the professional bodies is a useful means of dealing with disputes of a lesser scale, and should be encouraged.

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38 Disciplinary proceedings by the professional bodies are discussed further in Chapter 8.

39 See the discussion of the taxation of bills of costs submitted by bankruptcy trustees at paragraph 2.64.

10.78. The Working party recommends that:

- creditors should be given greater education about existing fee review mechanisms;
- the formal review mechanisms should be extended to encompass all types of corporate insolvency administrations;
- consideration should be given to empowering the CALDB to hear and make appropriate orders in relation to fee disputes in consultation with the professional bodies (particularly the IPAA); and
- the informal mediation system currently administered by the professional bodies should be encouraged to continue.

ASSETLESS ADMINISTRATIONS

10.79. Since the remuneration and expenses of liquidators are ordinarily funded from the assets of the company in liquidation, a difficulty is created when the corporation does not have sufficient assets to cover those expenses. Without the financial incentive of remuneration, there would appear little reason for practitioners to conduct such administrations.

10.80. A threshold issue in relation to assetless companies is whether there is any point in liquidating them as creditors do not stand to recover anything in any event. This issue was considered by the ALRC in the Harmer Report. The ALRC was of the opinion that there were strong reasons for encouraging administrations of assetless companies.[40] Allowing an assetless company simply to lie dormant, eventually to be deregistered, means that there would never be a review of the company's activities by someone other than the company officers. Unscrupulous directors could improperly move assets out of companies into related companies or appropriate the corporate property themselves. As long as they do not leave enough assets behind to pay for an administration, their activities would probably not be subject to scrutiny and they would not be subject to clawback provisions and other remedies available to a liquidator. Furthermore, the regulator would not find out about the conduct so the directors would not be subject to action by the regulator. This would leave little in the way of deterrence for illegal conduct and entering voidable transactions—rather it would be likely to encourage abuse.

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40 See Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraphs 337, 340 and 343.

10.81. If it is considered desirable to wind up assetless companies, it must also be considered who should pay for the winding up. The current system for dealing with these companies is described in detail in Chapter 9. Rarely is an assetless company wound up voluntarily, but if it is, creditors and/or members would need to indemnify the practitioner or provide funds 'up front' to cover costs. In court-ordered liquidations of assetless companies, the cost of obtaining the winding up order is borne by the petitioning creditor. In jurisdictions which use rotation systems, the cost of conducting the administration is paid directly by official liquidators on the rotation list and cross-subsidised by their clients generally, since their remuneration rates are adjusted to take into account unremunerative work. In jurisdictions where a nomination system is used, a 'professional' creditor sometimes subsidises particular practitioners to conduct all the assetless administrations in which they are a petitioning creditor on the basis that the practitioner will also be nominated for remunerative work. Sometimes one or more creditors will provide a practitioner with funds (or an indemnity) for the costs of conducting the administration. However, in many cases, creditors are reluctant to spend money on an administration when there is no prospect of a return. Consequently, no administration is conducted.

A Centralised Fund

10.82. In the Harmer Report, the ALRC canvassed various options for funding the administration of assetless companies with the aim of increasing the number of assetless companies which would be subject to a liquidation. The Commission favoured the creation of a centralised fund to which a wide class of persons would contribute.[41] Options considered for generating revenue for the fund included:

- payments by the directors of companies being wound up;
- increased filing fees for winding up applications;
- requiring all monies realised in administrations to be deposited by liquidators in a common account, with interest going toward the fund;
- diverting a proportion of the interest from trust accounts of practitioners into the fund;
- depositing assets from small insolvent estates (less than $1,000) into the fund rather than distributing the amounts to creditors; and

41 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraph 347.

- directing monies and dividends unclaimed by creditors in liquidations into the fund.[42]

10.83. Although the ALRC considered that the above sources of revenue could be considered further in the longer term, in order to quickly generate an initial source of revenue, the ALRC favoured the imposition of a levy on all companies to be paid at the time of lodging the annual return.[43]

10.84. The ALRC also made recommendations regarding the administrative aspects of the fund and how the fund would be recompensed if it eventuated that assets were in fact recovered in the course of conducting the administration.[44]

10.85. The establishment of a fund to finance administration of assetless companies was also supported by the former Trade Practices Commission in its report on the accounting profession, primarily on the basis that it would obviate the need for a rotation system for appointment of official liquidators.[45]

10.86. In response to its discussion paper, the Working Party received a number of submissions supporting the establishment of a fund along the lines proposed in the Harmer Report.

10.87. Options for financing an assetless administration fund raised in the submissions included:

- consolidated revenue;
- a levy imposed upon all companies at the time of incorporation; and
- a small levy on annual returns.

10.88. A further suggestion was that the directors of the companies concerned should be liable to reimburse the fund for monies spent on the initial investigations of their companies. This suggestion was opposed in another submission on the basis that directors should not be personally liable for expenses connected with their companies unless they are shown to have breached relevant legislation or their duties.

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42 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraph 348.

43 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraph 349.

44 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraphs 355-358.

45 Trade Practices Commission, *Study of the Professions, Final report—July 1992, Accountancy*, pp. 86–87.

10.89. There was a range of views on the uses to which the fund should be put. One suggestion was that it should only be used to fund investigations and prosecutions of directors and officers on the basis that, if the creditors do not wish to fund the investigations into possible asset recoveries, then neither should the public purse. Another suggestion was that the fund should be available to cover out-of-pocket expenses and the first stage of enquires. Any additional investigation or recovery work would continue to be funded by the creditors or the liquidator on a 'contingency basis'.

Alternatives

10.90. Although the creation of a centralised statutory fund to provide resources for private practitioners to conduct assetless administrations has received much support, there are some alternative suggestions aimed at addressing the difficulties associated with administrations of assetless companies.

10.91. One suggestion considered by the ALRC in the Harmer Report was the creation of a public office (similar to the Official Receiver in Bankruptcy). The holder of this office would have responsibility for conducting assetless administrations. This option was rejected by the ALRC in favour of maintaining the use of private sector practitioners to perform this work.[46]

10.92. The ALRC also considered a proposal whereby individual companies deposit a lump sum or bond with the regulator on incorporation to pay for costs of the administration which would become available when the company was wound up. Security for the bonded amount could be taken over assets of the directors. This proposal was rejected because it was likely to be difficult to administer and would impede the borrowing capacity of directors.[47]

10.93. A variation on the deposit of a bond would be a system of insurance whereby companies would be required to take out the insurance and liquidators would be permitted to make a claim on the policy in the event the company's assets did not reach a certain level. This has the advantage that the premiums would, in all likelihood, be less in dollar value than a bond. Unlike the bond, the premium would not be returned to companies which do not make an insurance claim. However, since the bond would only be returned on a solvent liquidation, it is questionable whether there is, in practice, a significant difference between this and a non-returnable premium.

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46 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraph 345.

47 Australian Law Reform Commission, *Report No 45, General Insolvency Inquiry*, (Mr R.W. Harmer, Commissioner-in-charge), AGPS, Canberra, 1988, paragraph 347.

10.94. A submission to the Working Party contained a suggestion that a bond could be lodged with the court by the petitioning creditor for an amount (for example, $5,000) to cover some costs of the administration. The bond would not be called upon if assets were realised to cover the costs. Although this proposal would provide resources to the practitioner to fund preliminary investigations, it may result in creditors becoming less keen than they already are to proceed with winding up applications in cases of apparently assetless companies. On the other hand, the establishment of a formal mechanism could be preferable to the current situation where creditors are requested to provide indemnities or 'up front' payments by practitioners on an ad-hoc basis. A formal mechanism may provide both parties with additional confidence that the other will fulfil their obligations.

10.95 A variation on this option would be to prescribe a fixed fee or indemnity which must be advanced by the nominating creditors in the event that the company is assetless. If a nominating creditor were willing to advance the prescribed fee, the nominated liquidator would not be allowed to refuse the appointment without the leave of the court or the ASC.

Conclusion

10.96. Each of the mechanisms suggested to deal with the assetless company situation have disadvantages. The central fund, insurance and bond systems would all impose significant costs in terms of the impositions on all companies and the administration of the schemes. Requiring a bond or indemnity to be lodged by a petitioning creditor focuses the burden on that creditor which may result in even less assetless companies being administered.

10.97. On balance, the Working Party favours a levy being placed on all companies, either at the time of incorporation or as part of the annual return fee, as a means of funding assetless administrations. The fund would be administered by the ASC and would apply to compulsory liquidations where there are no assets. It would provide liquidators with enough funds to prepare a report to creditors and a report to the ASC.[48]

10.98. However, it is important to ensure that any levy that companies would be required to pay was not so high as to adversely affect the ability of companies to compete, or constitute a barrier to entry. This is particularly important with respect to smaller companies. Accordingly, the Working Party considers that consideration

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48 The report would be made pursuant to section 533 of the Corporations Law. That provision requires a report to be made to the ASC where the return to unsecured creditors is less than 50c in the dollar or where it appears to the liquidator that officers and others involved in management may be guilty of an offence, negligence, breach of duty etc.

should be given to structuring the fund so that the levy payable is proportionate to the capacity of companies to contribute.

10.99. However, such a system has its drawbacks. The companies which are less financially sound are, by definition, the ones more likely to end up being involved in an assetless administration and causing diminution of the fund. Arguably, it is unfair to have financially sound companies, which are less likely to give rise to claims on the fund, contributing proportionately more to the fund than those companies which are likely to diminish the fund. Whether a proportional scheme is desirable will depend on the amounts involved. If the average levy required is small, the costs involved in administering a proportionate system are likely to outweigh the benefits. However, if the levy would have a significant impact on smaller companies, a scheme requiring proportionate contributions could be desirable for the reasons outlined above.

10.100. The Working Party recommends that:

I. the Government consider the establishment of an assetless administration fund along the lines recommended by the ALRC to fund preliminary investigations of breach of directors' duties and fraudulent conduct; and

II. the ASC should liaise with practitioners with a view to developing guidelines about the content of reports, particularly in the case of assetless companies, which should serve to avoid needless work on the part of practitioners.