Arnold Bloch Leibler
Lawyers and Advisers

5 August 2011

By E-mail

Our Ref LZ JOM
File No. 010444444

Contacts
Leon Zwier
Direct 61 3 9229 9646
lzwier@abl.com.au

Jonathan Milner
Direct 61 2 9226 7237
jmilner@abl.com.au

The Manager
Governance and Insolvency Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: insolvency@treasury.gov.au

MELBOURNE
SYDNEY

To whom it may concern

Arnold Bloch Leibler's response to Insolvency Options Paper released on 2 June 2011

Arnold Bloch Leibler (**ABL**) welcomes the opportunity to respond to the Options Paper entitled "*A modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia*" released by the Australian Government on 2 June 2011 (**Options Paper**).

The purpose of this submission is to address aspects of the Options Paper. ABL's experience is predominantly in larger corporate collapses and reconstructions which have unique, complex and distinct problems. For example, ABL has recently been involved in numerous large corporate insolvencies and reconstructions including Alinta, Centro, Willmott Forests, Great Southern, Sonray and DFO. Our comments therefore predominantly relate to our experience in those larger corporate matters.

In this submission we make some introductory remarks about the need to exercise care in shifting the current balance of stakeholder rights in corporate insolvencies, and then make specific comments about the following aspects of the Options Paper:

(a) standards for entry and registration;

(b) communication and monitoring; and

(c) removal and replacement.

At the conclusion of this submission we also make some brief observations on the role played by receivers and managers in the corporate insolvency process.

A Introductory remarks

1 The Options Paper makes a realistic and measured assessment of the state of the insolvency profession.

2 Importantly, the Options Paper appears to recognise that in the course of performing their duties, insolvency practitioners must necessarily:

(a) make impartial and well informed decisions; and

(b) make those decisions speedily and sometimes at significant personal risk.

3 The insolvency process involves a range of disgruntled stakeholders with often widely divergent interests and widely divergent understandings of the process. In different ways, the law recognises and balances all stakeholder interests. The insolvency practitioner must apply the law; in doing so, he or she engages in a process of balancing stakeholder interests.

4 This process can be frustrating for stakeholders, and such frustration is often caused by a lack of knowledge, understanding and information. It follows that legislative amendments that enhance stakeholder knowledge and increase the flow of information to creditors, should be considered. Furthermore, if the law can be amended to improve the balance between stakeholder interests, those amendments should also be considered.

5 However, small legislative amendments can have unintended consequences, and may upset the current balance of stakeholder interests. This potentially opens up new areas of controversy. Some of those areas may only become apparent after any amendments have been enacted. For this reason, we submit that changes to the status quo should not be made unless such changes are clearly necessary.

B Standards for Entry and Registration Process

6 We agree that raising standards and increasing competition in the corporate insolvency profession is a worthwhile aim.

7 Nevertheless, as the Options Paper appears to recognise, top tier corporate insolvency professionals provide a bespoke service. Few larger corporate insolvencies present identical or even similar challenges. Each corporate insolvency involves a different corporate entity (or entities), conducting a different business and usually operating in a different market (and economic environment).

8 Insolvency practitioners must therefore possess highly developed skills and a high degree of experience to understand the business and structure of the insolvent company, including its financial position and the market in which it operates.

9 The insolvency practitioner's role is made even more difficult by the sometimes short statutory timeframes within which he or she is required to develop this understanding and recommend or implement solutions.

10 Moreover, while there are inherent (and often unavoidable) difficulties with the corporate insolvency process, our experience is that top tier

corporate insolvency practitioners are able, committed and experienced and tend to achieve good results.

11 Having made these general comments, we address below some of the specific suggestions for reform outlined in the Options Paper.

B.1 Standards for entry

12 Opening up the insolvency profession to lawyers and management consultants may, in the short term, put downward pressure on the cost of corporate insolvency.

13 However, if standards for entry are not carefully regulated, we think that in the medium or longer term, opening up the profession could:

(a) increase the cost of the insolvency process; and

(b) result in a decrease in stakeholder satisfaction.

14 Top tier insolvency practitioners need to be appropriately qualified and experienced.

15 Mandating appropriate qualifications is a relatively simple task. We submit that the nature of the insolvency practitioner's role requires an emphasis on accounting and finance skills as a condition of registration.

16 The requirement that a practitioner have necessary 'experience' is easier to state as a principle than to achieve in practice. The experience required to conduct a large, complex insolvency can only be obtained through practical experience. It is, for example, difficult to conceive of a training program that would adequately prepare most lawyers, even those who are experienced insolvency lawyers, for the reality of life as an insolvency practitioner.

17 In short, we do not think that the solution to the issues identified in the Options Paper is to lower barriers to entry. The guiding principle should be to ensure that all insolvency practitioners are appropriately qualified and experienced.

18 For this reason, if the law is amended to allow non-accountants to take appointments, it should be a requirement that those individuals have:

(a) a minimum level of tertiary accounting / finance qualifications;

(b) obtained experience working alongside a registered insolvency practitioner for a minimum defined period; and

(c) worked directly with a registered insolvency practitioner on a minimum number of formal insolvencies;

(d) adequate resources, including appropriately qualified staff members.

B.2 Large and complex insolvencies

19 Not all 'qualified' insolvency practitioners are capable of properly managing large and complex insolvencies.

20 In our opinion, it is important to attempt to ensure that the experience and capacity of insolvency practitioners matches the size of the insolvency to which they may be appointed.[1]

21 There has been judicial recognition that managing large and complex insolvencies requires a certain level of experience and resources. In *Commonwealth Bank of Australia v Fernandez* (2010) 81 ACSR 262 (***Fernandez***), secured creditors of the Willmott Forest managed investment schemes (supported by ASIC) applied to have the voluntary administrator removed and replaced. It was said that the administrator did not have the capacity or expertise to perform tasks which would be required in the administration. The application was heard by Finkelstein J, who was then widely recognised as one of Australia's pre-eminent insolvency judges. His Honour ordered the removal and replacement of the administrator, even though the administrator's personal integrity was not in question. In doing so, his Honour made a number of pertinent comments (at 273-274). In summary, his Honour said:

(a) In relation to the size of the task at hand:

> *"... I do not think [the administrator] appreciates the potentially enormous task that will confront an administrator of the Willmott Forests group; and (2) there is little (probably no) possibility that [the administrator] and his staff have the capacity to carry out the tasks that will need to be performed.*
>
> *... There are several well known and large agribusiness schemes that are presently in administration or in the process of being wound up. Each has hopes of finding a white knight to take over the operation of its schemes. None has come forward with a realistic proposal. The result is a growing web of complex litigation as secured creditors, ordinary creditors and investors struggle to get what they can of assets that are insufficient to meet all their claims. I fear that will be the likely reality for the Willmott Forests schemes as well."*

(b) In relation to the administrator's experience and qualifications:

> *"There are, to my mind, two things that highlight [the administrator's] failure to appreciate the task at hand. The first was his inability to appreciate that the investors are, or are likely to be, creditors of WFL and, perhaps, other group companies. This is a point that would have occurred to an insolvency practitioner experienced in*

[1] The practice of dividing the list of official liquidators into the 'A' and 'B' lists provides an early example of stratification.

> *managed investment schemes. Indeed, it was his lack of appreciation of the position of scheme members that led to the adjournment of the first meeting, no doubt at considerable expense.*
>
> *The second thing is [the administrator's] failure to turn his mind to whether he had appropriate insurance cover... Naturally, [the administrator] indicated he would increase his cover to an appropriate level. That, however, is not the point. The point is that a practitioner with an appreciation of what is likely to be involved in a particular administration would have arranged appropriate insurance cover before the problem was pointed out, as it was, in this case, by ASIC.*

(c) More generally:

> *"[The administrator] has what may best be described as a "one man" (perhaps, more aptly, a "one person") practice. [The administrator's practice] employ[s] four accountants (two of whom are contractors), but [the administrator] did not suggest that any of them has the experience required to handle a complex administration. He also employs four investigation, asset management and administration staff, one investigation and asset management contractor and three administration staff contractors. This is nowhere near sufficient for the task at hand. And, the lack of staff cannot easily be made up. No doubt there are accountants that can be contracted on a short-term basis to make up the numbers. But it is not enough simply to build up the numbers. What is required are personnel with the appropriate experience and skills. In today's market, where insolvency practitioners are working on many large administrations, it is unlikely that good people can be found at short notice for what will, at best, be a temporary position."*

22 His Honour recognised and explained what, for most experienced top tier corporate insolvency practitioners, is an obvious obstacle to the effective conduct of a large and complex insolvency administration - the absence of experience, expertise or resources.

23 In *Fernandez*, it was necessary for secured creditors, supported by ASIC, to make what was presumably a costly, time consuming and distracting application to have the administrator removed.[2] The application in *Fernandez* should not have been necessary. In many cases, stakeholders may not have the funds or the inclination to make a Court application to remove an insolvency practitioner.

[2] In a different context, see I*n the Matter of Signature Pacific Pty Ltd (Subject To Deed of Company Arrangement)* [2010] NSWSC 1160 at [8].

24 We submit that regulations or professional rules should be considered which would have the effect of stratifying the corporate insolvency profession, at least in relation to the size and complexity of the insolvency.

25 While overly prescriptive rules or regulations would be unworkable, regulations could be introduced to mandate, at least by reference to the size[3] of the insolvent corporation, that the insolvency practitioner have:

(a) a minimum number of qualified staff; and

(b) a minimum level of experience,

in order to qualify for appointment to large and complex corporate insolvencies. In any event, at a minimum, insolvency practitioners should be required to have regard to such matters before accepting an appointment.

C Communication and Monitoring

26 The communications and monitoring chapter in the Options Paper raises a number of issues for comment. Those issues broadly relate to:

(a) communications with creditors;

(b) the ability of creditors to call a creditors' meeting; and

(c) the ability of creditors to direct the insolvency practitioner.

C.1 Communicating with creditors

27 *The Code of Professional Practice for Insolvency Practitioners* provides that "*practitioners must exercise their professional judgment when balancing the needs of individuals for information or responses to inquiries with the overall efficiency and costs of the administration*". We submit that the same balancing exercise should be undertaken when determining whether any amendments should be made to the current legislative framework in relation to communication with creditors. It is important for insolvency administrations to be as transparent as reasonably possible, but not to the extent of creating unnecessary cost and distraction.

28 We submit that the reporting duties of a liquidator should be the same, to the extent reasonably possible, in a compulsory liquidation as in a voluntary liquidation.[4]

29 We do not support the proposal to impose a general obligation on administrators and liquidators to provide creditors with information when

[3] "Size" is a subjective term and the criteria would need to be considered carefully. Relevant criteria could, for example, include the number of employees, size of the balance sheet and quantum of the company's debt facilities.
[4] See Options Paper at [242]. Note our discussion below at paragraph 34 regarding the holding of an initial creditors' meeting in compulsory liquidation.

reasonably requested.[5] An insolvency practitioner's primary duty is to the creditors as a whole. Administrators and liquidators should not ordinarily spend creditors' money dealing with requests for information from individual creditors, where such requests are for the benefit of that individual only and not the creditors as a whole. For this reason, section 486 of the *Corporations Act 2001* (Cth) (**Corporations Act**) gives creditors a right to apply to the Court to inspect company books. In practice, administrators and liquidators often voluntarily provide information to creditors upon request. Nonetheless, administrators and liquidators should have a discretion to refuse to provide information in certain circumstances (for example, where the information is sensitive, or where it appears that the creditor is conducting a fishing expedition or attempting to achieve some collateral objective). A 'reasonableness' standard necessarily creates some ambiguity, and administrators and liquidators may err on the side of caution by providing information even when it is not in the interests of creditors as a whole to do so.

30 In addition to the amendments proposed in the Options Paper, we also submit that several discrete amendments should be made to the Corporations Act to facilitate improved communication between insolvency practitioners and creditors:

(a) First, section 486 of the Corporations Act should be amended to give a liquidator a discretion to allow a creditor to inspect company documents. At present, the section has been interpreted to prohibit a liquidator from voluntarily allowing a creditor to inspect books.[6]

(b) Secondly, liquidators should be required to publish, on the internet, updates to creditors. While it is not mandated, our experience is that liquidators often use online updates to creditors as a mechanism for communicating with creditors without having to resort to costly meetings. We submit that liquidators should be required to publish such updates, from time to time, in order to provide information to creditors and other stakeholders on the progress of the liquidation. This is a cost-effective means of communication. The language of any amendment should be flexible in relation to the timing of updates. A liquidator should have a discretion to decide in what circumstances an update should be provided and how frequently, although circulars should at least be published where there are material new developments. This would codify what is, in any event, current best practice for insolvency practitioners.

We do not think there should ordinarily be an equivalent obligation on administrators to post online updates. The Corporations Act provides limited but appropriate channels of communication between administrators and creditors (for example, reporting requirements under section 439A). The focus of an administrator's activities should be on progressing

[5] Options Paper at [297].
[6] *IACS Pty Ltd v Australian Flower Exports Pty Ltd* (1993) 10 ACSR 769

investigations, promptly convening the second meeting of creditors and otherwise working to facilitate the objectives of section 435A. However, it is increasingly common in large administrations for the convening period for the second creditors' meeting to be extended for considerable lengths of time. We submit that administrators should be required to provide on-line updates, as set out above, in cases where the convening period has been extended beyond a specified period of time.

(c) Thirdly, we advocate consideration of a further discrete reform to facilitate communications between insolvency practitioners and creditors regarding actual or contemplated litigation. Our recent experience in several large corporate insolvencies is that insolvency practitioners often find it difficult to communicate candidly to a committee of inspection, and to an even greater degree, to the body of creditors generally, about litigation which the company may pursue. The concern is that such communications may waive legal professional privilege.

The law regarding waiver of privilege can be a potential minefield for insolvency practitioners. For example, a liquidator will not waive privilege in legal advice communicated to a committee of inspection in circumstances where the liquidator and the committee of inspection have a 'common interest' in that advice, and the advice relates to current or anticipated litigation.[7] Australian courts have stated that a 'common interest' can take many forms, and arise in a 'variety of potential relationships'.[8] However, creditor representatives on a committee of inspection often have interests which are potentially adverse, and it will not always be the case that the liquidator and the committee of inspection, or any individual members of the committee of inspection, have an identity of interest. Insolvency practitioners should be able to disclose to creditors the substance of legal advice they have obtained in relation to potential or actual litigation without fear of waiver. Litigation is often an important part of an insolvency process, and creditors and insolvency practitioners are often frustrated by the perceived inability to communicate candidly.

Consideration should therefore be given to amendments to the Corporations Act that would enable insolvency practitioners to communicate more freely with committees of inspection or creditors in general about existing or potential litigation. In our view there are at least two possibilities worth exploring:

---

[7] *Buttes Gas & Oil Co v Hammer* (No 3) [1981] QB 223 at 242-3 per Lord Denning MR (the House of Lords reversed this decision on different grounds and expressed no opinion about common interest privilege: [1982] AC 888); approved in *Somerville v Australian Securities Commission* (1995) 131 ALR 517 at 528.

[8] See, for example, *State of SA v Peat Marwick Mitchell* (Unreported, Supreme Court of SA, Olsson J, 14 September 1995) at 4. Also see, with particular reference to common interest privilege in the context of a liquidation, *In the Matter of Bauhaus Pyrmont Pty Ltd (In Liq)* [2006] NSWSC 543, per Austin J at [56]-[63].

(i) creating a new form of statutory privilege, similar to public interest privilege, providing that any communications by an insolvency practitioner to members of a committee of inspection (in their capacity as members of that committee) in relation to potential or actual causes of action of the company are inadmissible as evidence in subsequent proceedings; or

(ii) making it clear that, prima facie, any communications between an insolvency practitioner and the committee of inspection are confidential and that disclosure of any otherwise privileged communication to members of the committee of inspection (in their capacity as members of that committee) does not constitute a waiver of legal professional privilege.

Clearly, the drafting of any provisions would need to be carefully considered.

However, we do not recommend that the legislation be amended to *require* an insolvency practitioner to disclose legal advice.

C.2 Power to call meetings

31 Currently, in addition to the meetings prescribed by the legislation, creditors in a Court-ordered liquidation may request in writing that the liquidator convene a meeting, and a liquidator must do so. The creditors who call the meeting bear the cost of the meeting.[9]

32 We do not support an amendment requiring a registered liquidator to call a meeting of creditors for any purpose whenever reasonably requested.[10] A more workable mechanism for communication is already contained in section 549 of the Corporations Act, whereby a member of a committee of inspection has the power to convene a meeting of the committee. The committee of inspection can also resolve that the company bear the cost of the meeting.[11] This mechanism allows liquidators and a workable group of creditors to liaise and discuss issues arising from the liquidation without putting the company to the cost of convening a meeting of all creditors.

33 We also disagree with the proposal that the Corporations Act be amended to provide that, in an administration (and also in a liquidation), where 25 per cent of creditors by value wish to call a meeting, the cost of the meeting be borne by the company.[12] There may often be administrations or liquidations where a single creditor holds more than 25 per cent of the value of claims against a company, and could potentially abuse the power to call meetings.

[9] *Corporations Act 2001* (Cth) s 479 and *Corporations Regulations 2001* (Cth) reg 5.6.15(1).
[10] Options Paper at [295].
[11] Corporations Regulations 2001, reg 5.6.15(2).
[12] Options Paper at [295].

34 We do, however, submit that some reforms regarding the calling of meetings by creditors are warranted:

(a) First, the position between voluntary and Court-ordered liquidations should be aligned so that creditors in a voluntary liquidation have the same power as creditors in a Court-ordered liquidation to pass a resolution requiring a future creditors' meeting to be held (or if creditors representing at least one-tenth in value of the creditors request in writing that the liquidator convene a meeting, the liquidator must do so but those who convene the meeting must pay the costs of calling and holding the meeting).[13]

(b) Secondly, where creditors representing at least one-tenth of the value of claims request a creditors' meeting, a mechanism should be introduced to enable such creditors to be reimbursed, where appropriate, for the cost of convening such a meeting. We submit that a provision could be introduced that allows:

(i) creditors at the meeting to pass a vote (by majority of creditors in number and value) in favour of the company reimbursing the relevant creditors for the cost of the meeting; or

(ii) the creditor(s) who requested the meeting to make an application to the Court for an order that the company reimburse them for the cost of the meeting where the Court considers that it is reasonable for the company to do so.

C.3 Power to direct insolvency practitioner

35 Insolvency practitioners have responsibilities to creditors as a whole, and also potentially to other stakeholders (for example, beneficiaries of a corporate trustee). They must apply expertise, experience and professional judgment when making decisions about the conduct of the insolvency administration. This may require them to make decisions which are both perfectly proper but widely unpopular with creditors (or the majority of creditors). To require insolvency practitioners to act on the direction of a majority of creditors (or on the direction of an alliance of creditors) would encroach on the fundamental principle of an insolvency practitioner acting impartially in respect of all relevant stakeholders.

36 It is also important to recognise that while an insolvency practitioner should not necessarily be directed by creditors, the practitioner should be accountable to creditors. Insolvency laws establish various mechanisms for keeping insolvency practitioners accountable. At Section D1 of this submission we recommend amendments to the Corporations Act to increase the power of creditors to remove liquidators in certain circumstances in the initial phase of a compulsory winding up.

[13] *Corporations Act 2001* (Cth) s 479.

This proposed amendment, in combination with other existing accountability checks, provides a safeguard for creditors and strikes the appropriate balance between:

(a) the essential requirement that the insolvency practitioner have the discretion to steer the course of the administration or liquidation; and

(b) the need for creditors to have a means of protecting their interests, particularly in circumstances where an administrator or liquidator is not properly discharging his or her duties.

37 We do, however, submit that a reform is warranted which would require a liquidator in a voluntary winding up to have regard to the wishes of a committee of inspection. As the law stands, a liquidator in a Court-ordered winding up must have regard to directions given by resolution of the creditors at a general meeting or by a committee of inspection, with a direction from creditors overriding any direction of a committee of inspection in cases of conflict.[14] This is not the case in a voluntary liquidation, as Barrett J observed in *Onefone Australia Pty Ltd v One.Tel Ltd* (2008) 69 ACSR 290] (at [45]):

> "*In the absence of any counterpart of s 479(1) in relation to creditors voluntary winding up, it must be accepted that, unless a particular power is conferred by statute on a committee of inspection in such a winding up, the committee's position involves, at the very most, Bagehot's view of the privileges of the Crown, that is, to be consulted, to advise and to warn: W Bagehot, The English Constitution, Collins, 1963, p 67. A liquidator in a creditors voluntary winding up is not bound to have regard to any directions the committee of inspection may give; and the committee has no formal power to direct the liquidator.*"

We see no reason why liquidators in a voluntary winding up should not have a commensurate obligation to consider the wishes of a committee of inspection.

D Removal and Replacement of Insolvency Practitioners

38 The Options Paper discusses various issues regarding the removal and replacement of insolvency practitioners, which broadly concern:

(a) the ability of creditors to be involved in the selection of the insolvency practitioner during the initial phase of the relevant insolvency administration;

(b) the ability of creditors to remove and replace insolvency practitioners after the initial phase of the insolvency administration; and

[14] *Corporations Act 2001* (Cth) s 479(1).

(c) practical requirements to facilitate the handover from an insolvency practitioner who has been removed to the replacement insolvency practitioner.

We address each of these issues separately.

D.1 Replacing insolvency practitioners during the initial phase of an insolvency administration

39 There are strong reasons for giving the body of creditors a broad right to select the insolvency practitioner during the initial phase of an insolvency administration. The key point is that creditors as a whole are better placed to select an appropriate insolvency practitioner than, say, the directors of a company who may have appointed voluntary administrators. This principle is reflected in the fact that in all forms of insolvency administration, except for compulsory liquidation, the creditors as a whole are given the opportunity to select the insolvency practitioner at an early stage of the insolvency administration.

40 The rationale for the exception for compulsory liquidations is not entirely clear, but may be due to the fact that the appointee in a compulsory liquidation must be an official liquidator appointed by the Court, while in a voluntary winding up the appointee need only be a registered liquidator appointed by the creditors or members.[15] As such, the liquidator in a compulsory liquidation is formally regarded as an 'officer of the Court',[16] whereas the liquidator in a voluntary liquidation is not.[17] The argument presumably goes that while creditors may have the power to remove a liquidator appointed by them, an officer of the Court should only be removed by the Court itself.

41 The soundness of this rationale is undermined by the practical reality of how liquidators are appointed in compulsory liquidations. As the Options Paper notes, Courts generally appoint the insolvency practitioner nominated by the petitioning creditor.[18] The views of the petitioning creditor regarding the appropriate insolvency practitioner may not accord with the views of the creditors as a whole. Furthermore, the Court is not in a position to make an informed decision about which practitioner would be most appropriate for each compulsory liquidation.

42 Subject to some practical qualifications discussed below, we therefore think that the body of creditors should have an opportunity, during the initial phase of a compulsory liquidation, to replace the Court-appointed liquidator.

43 The Options Paper raises the practical issue of whether, in a compulsory liquidation, it is necessary to convene a creditors' meeting to allow the

15 Michael Murray, *Keay's Insolvency Personal and Corporate Law and Practice* (6th ed) (2008), 254.
16 *Corporate Affairs Commission (Vic) v Harvey* [1980] VR 669, 695; *Monck v NCSC* (1992) 6 ACSR 625, 632.
17 *Re David A Hamilton and Co Ltd (in liq)* [1928] NZLR 419; *Monck v NCSC* (1992) 6 ACSR 625, 632; *McDonald v Hanselmann* (1998) 28 ACSR 49, 51.
18 Options Paper at [514].

creditors to replace the liquidator, or whether some other mechanism, such as a mail-out, would be more appropriate. Putting aside assetless companies, we think there are usually good reasons for requiring a meeting to be convened. The reasons include that:

(a) it may be appropriate to convene a meeting in any event, to deal with matters such as constituting the committee of inspection, remuneration and so on;

(b) a meeting, as compared to a mail-out, would usually be a more effective forum for debating contentious issues about the selection of competing insolvency practitioners, and Courts themselves have recognised the importance of meetings as a medium for communication between creditors and insolvency practitioners;[19]

(c) it is our experience that, in insolvency administrations where initial meetings are required, it is rare for the meeting to be an unnecessary exercise or a wasted expense, if for no other reason than it facilitates better communication between creditors and insolvency practitioners.

We therefore submit that the Corporations Act should be amended to introduce a requirement to hold a first creditors' meeting in a compulsory liquidation, similar to that required for a voluntary liquidation.

44 Where a company is assetless, the liquidator should be excused from incurring the costs of convening and holding a creditors' meeting (or for that matter, incurring the costs of a mail-out).[20] However, the liquidator should be required to hold such a meeting if requested in writing by creditors who: (i) represent at least one-tenth in value of the creditors;[21] and (ii) pay the costs of convening and holding the meeting. In this way, if creditors are sufficiently motivated to replace a Court-appointed liquidator of an assetless company, the creditors will be able do so.[22] We therefore do not think that it would be necessary to make special provision for assetless companies in relation to a requirement to hold a first creditors' meeting.

D.2 Replacing insolvency practitioners after the initial phase of an insolvency administration

45 The critical issue here is whether creditors should have a similar right to that found in section 181 of the *Bankruptcy Act 1966* (Cth) (**Bankruptcy Act**), to replace insolvency practitioners by resolution without needing to

[19] *Re Love, as liquidator of ACN 007 368 257 Ltd No 1* (2003) ACLC 592, 602.
[20] *Corporations Act 2001* (Cth) s 545.
[21] *Corporations Act 2001* (Cth) s 479(2).
[22] It should be noted that under current guidelines for the administration of ASIC's Assetless Administration Fund, funding is not ordinarily available for the costs of convening a meeting, and is generally used to fund investigations and similar activities: see ASIC RG109: *Assetless Administration Fund: Funding Criteria and Guidelines*. Our view is that, given the limited funds available and the paramount importance of conducting investigations, it is inappropriate to allow the cost of convening meeting to be sought through the Assetless Administration Fund.

show any cause. This requires a careful balancing of considerations for and against such a broad right of removal by creditor resolution.

46 We generally agree with the observations in the Options Paper regarding the difficulty of removing liquidators or deed administrators under the current 'cause shown' removal provisions.[23] Our experience is that there are significant difficulties, both substantively and procedurally, in succeeding with applications under such provisions and that litigation arising from removal applications is often bitterly fought and expensive, and the costs of such battles are usually borne by the company and its creditors.

47 Apart from the difficulties associated with removing liquidators, there is also a broader question of whether it should be necessary in the first place to 'show cause' to remove an insolvency practitioner. Although it is not necessary to show misconduct on the part of the insolvency practitioner in order to show cause, the reality is that in the absence of misconduct, Courts typically require proof of some compelling and obvious commercial reason before removing the insolvency practitioner.

48 On the other hand, as the Options Paper also notes,[24] a broad power of removal by resolution creates a risk that creditors will either abuse the process or make poor decisions.

49 In our view, amending the Corporations Act to give creditors a broad power of removal at any time during an insolvency administration would present an unacceptable risk of abuse. This risk was identified and explained by Warren J in *Multi-Core Aerators Pty Ltd v Dye* [1999] VSC 205 at [48]:

> "... *it is not sufficient that a court remove a liquidator merely because of levels of feeling and rancour between parties especially where the hostility has at all times emanated from the party seeking the removal of the liquidator. To do so would provide a creditor with an opportunity to manipulate the liquidation of the company. In my view to accede to the application of the applicant in the present matter would be to disregard the principle that the onus of proof borne by an applicant will not be easily discharged if the liquidator has become well acquainted with the business and affairs of the company and/or the process of winding up has almost reached completion* ..."[25]

50 Introducing a broad power of removal would magnify the risk of manipulation of the course of the insolvency administration in favour of a majority of creditors. Majority creditors could attempt to direct the course of the insolvency either by requisitioning a meeting and voting for removal of the incumbent insolvency practitioner or by threatening the

[23] Options Paper at [539]ff.
[24] Options Paper at [562]-[563].
[25] Also see *Network Exchange Pty Ltd v MIG International Communication Pty Ltd* (1994) 13 ACSR 544 at 550-551.

insolvency practitioner with removal if he or she does not act in accordance with the directions of the majority.

51 Recently, we have been involved in a matter where the committee of inspection insisted that a liquidator run a Court application as a condition of approval of his fees. A broad power of removal would exacerbate this type of behaviour by majority creditors and cannot be countenanced.

52 For these reasons, we submit that the current status quo should be maintained.

D.3 Facilitating the hand-over from the existing insolvency practitioner to the replacement insolvency practitioner

53 We agree with the proposal that provisions facilitating the transfer of documents from an existing insolvency practitioner to his or her replacement be introduced in the Corporations Act.[26] Such a transfer should be facilitated to the maximum extent reasonably possible. To ensure this is the case, the transfer provisions will likely need to address several issues.

54 The Options Paper notes that under rules for legal practitioners, the prior solicitor retains a lien over the files until their fees are paid.[27] The Options Paper further notes that there may be scope for the priority rules in both corporate and personal insolvency administrations to address this issue. We submit that:

(a) there is no need to allow former insolvency practitioners to have a lien over the insolvency administration file; and

(b) allowing such a lien would be detrimental to the course of the insolvency administration.

55 The positions of legal practitioners and insolvency practitioners differ in several key respects.

56 First, unlike legal practitioners, insolvency practitioners have an equitable lien (and in the case of administrators, a statutory lien[28]) over property of the company or bankrupt's estate in respect of costs and remuneration reasonably incurred.[29] That equitable lien does not depend on possession and survives in the event of the appointment of a replacement insolvency practitioner.

57 Secondly, a solicitor's lien is asserted against a client who has, in breach of a retainer, failed to make payment. The lien is asserted against a blameworthy party. In contrast, if an insolvency practitioner were to assert a lien over the administration file, this would be to the detriment of

[26] Options Paper at [565]
[27] Options Paper at [552].
[28] *Corporations Act 2001* (Cth) s 443F.
[29] See in relation to corporate insolvency, Tracey Dumbo, "The Equitable Lien as Security for an Insolvency Practitioner's Right to Payment" (2007) 17 *JBPLP* 263.

blameless parties, namely the incoming insolvency practitioner and, ultimately, creditors.

58 Furthermore, the material which is required to be transferred to a replacement insolvency practitioner should not depend on a distinction between books of the company, on the one hand, and books of the outgoing insolvency practitioner, on the other. At a minimum, the books to be transferred should be books of the company and books of the outgoing insolvency practitioner created for the purposes of the insolvency administration.

59 A related issue which we have encountered arises where a former insolvency practitioner has engaged lawyers, and those lawyers then assert a solicitor's lien over the legal file (particularly where the replacement insolvency practitioner wishes to engage new lawyers). Asserting the solicitor's lien can have a significant impact on the hand-over to the new insolvency practitioner. We submit that insolvency laws should be amended to prevent the solicitor's lien being enforced in such circumstances as the potential for disruption to a hand-over outweighs the prejudice to the solicitor.

E The role and influence of Receivers[30]

60 As will be apparent from our submission, our experience is that stakeholder discontent can often be traced to the actual or perceived failure of insolvency practitioners to communicate meaningfully with stakeholders.

61 While we have addressed some of these communication issues elsewhere in our submission, we also think that there is a lacuna in the Options Paper in that it makes no reference to the role played by Receivers in the corporate insolvency process.

62 While a Receiver's principal role is to collect, manage and realise the assets charged, with a view to liquidating the secured creditor's debt, a Receiver is required to pay certain debts in priority to those charged under the security documents.[31]

63 More generally, unsecured creditors (who do not have any rights to priority payment) have an interest in the conduct of any receivership because, however remote or unlikely, in the absence of any second or subsequent mortgagees, any surplus from the realisation of the charged assets must be paid by the Receiver to the company.

64 However, despite the interests of unsecured creditors in the activities of a Receiver, a Receiver's general reporting requirements are limited. In particular, the Corporations Act requires:[32]

[30] Unless otherwise specified any references to "Receivers" should be taken to mean "Receivers and Managers".
[31] See for example *Corporations Act 2001* (Cth) s 433.. Also see ss 329 and 560.
[32] There are also advertising and other notification requirements which are not relevant for present purposes.

(a) a Receiver to keep accounting records to correctly explain all transactions entered into as Receiver and to make those records available for inspection by creditors;

(b) a '*managing controller*' (being a Receiver and Manager, but not a Receiver), to prepare and lodge a Report as to Affairs with ASIC within two months of the appointment date;[33]

(c) a Receiver to lodge with ASIC six monthly accounts of his or her receipts and payments with the regulatory authorities;[34] and

(d) a Receiver, after ceasing to act, to lodge notices in a prescribed form with ASIC and to lodge a final account (within one month after ceasing to act).[35]

65 Receivers are not otherwise required to report directly to the general body of unsecured creditors, or to any voluntary administrator or liquidator.

66 While our experience is that Receivers in large, complex corporate insolvencies usually do provide ongoing reports and information to voluntary administrators and liquidators (and, through them, unsecured creditors), other than as set out above, there is no statutory requirement to do so.

67 The lack of communication from Receivers about the progress of the receivership, its likely outcome and the consequences for unsecured creditors, can cause frustration and discontent. For this reason, we submit that there should be a statutory requirement for Receivers to provide periodic online updates to the general body of unsecured creditors (similar to the proposed reform for administrators and liquidators discussed above at paragraph 30).

68 Introducing a statutory obligation to this effect would come at a cost. It follows that consideration would need to be given to the timing of any periodic reporting requirements and the content of reports.

F Conclusion

69 Stakeholder dissatisfaction in large and complex corporate insolvencies is largely caused by three related factors. The first is the nature of the process, which necessarily involves an independent third party making decisions which can crystallise substantial financial loss for stakeholders. The second is a lack of stakeholder involvement in, and understanding of, the process. The third is the cost of the process

[33] The report must be current to within one month of the date of preparation. The report is available for inspection by the public upon payment of a prescribed fee.
[34] The accounts are then available for public search on the company's search record.
[35] The account must show: the receipts and payments since the last account up to the date of ceasing to act; the aggregate amount of the receipts and payments during all preceding periods since the appointment; the amount owing under the debenture at the date of the appointment and at the date of ceasing to act, and an estimate of the total value of all assets of the company which are subject to the debenture.

(which is often unavoidable) and the perception that by incurring those costs, insolvency practitioners reduce the pool of assets available to creditors.

70 Lowering barriers to entry to the insolvency profession will not address these issues and may exacerbate them.

71 In our view, the most appropriate way to mitigate stakeholder discontent is to:

(a) maintain and increase standards of entry to the profession;

(b) where possible, make discrete amendments to the law to enhance stakeholder communication.

72 The proposals contained in our submission only introduce incremental changes to the statutory framework. Nonetheless, we believe that these changes will increase stakeholder satisfaction without disturbing the appropriate balance of stakeholder interests.

We would be pleased to expand on any of the matters addressed in this submission.

Yours sincerely

Leon Zwier
Partner

for **Jonathan Milner**
Partner