23 September 2016

External Dispute Resolution Review
Financial System Division
The Treasury
Langton Crescent, Parkes ACT 2600

By email: EDRreview@treasury.gov.au

Dear Sir/Madam

Submission regarding Recommendation 13

Thank you for the opportunity to provide comment on Recommendation 13 of the Small Business Loan Inquiry by the Small Business and Family Enterprise Ombudsman and its referral to you.

Our key points, detailed later in our submission, for your consideration are:

- Investigative Accountants (IAs) provide an opinion to their client, the lender. An opinion is an exercise in professional opinion and, in our view, cannot be arbitrated or mediated

- If an IA's professional opinion was later held to be wrong then it may give rise to a claim by the lender, but there is no contract between the IA and the borrower and so we do not see how an IA's work would ever give rise to a claim by a borrower.

- Noting ARITA's own endeavours to establish a voluntary EDR scheme, we would like to have input into the proposed legislation to minimise the risk of unintended consequences:
  - Any EDR needs to be constructed carefully because it has the potential to impact on regulation and supervision, obligations to protect privacy, the maintenance of legal professional privilege, and capacity to access professional indemnity insurance.
  - An EDR should not result in an outcome that might result in a breach of the receiver's statutory duties.

- We do not believe that FOS is the appropriate place for an EDR scheme for receivers:
  - An EDR would also need to involve highly technical specialist expertise that we do not believe FOS has nor should develop.
  - Receivers are appointed in some cases by the Courts and in increasingly many cases by non-banks. It would be confusing for borrowers if there was

different access to EDR for each of those different types of appointee.

- We agree that formal insolvency appointments may give rise to claims that may be best resolved via EDR and for that reason we are trialling an EDR soon. We believe that any mandatory EDR should be constructed following a review of that trial

We would be delighted to provide any further information or meet with you and your Inquiry team to assist in any possible way. Please do not hesitate to contact me on 02 8004 4355 or jwinter@arita.com.au

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents practitioners and other associated professionals in Australia who specialise in the fields of restructuring, insolvency and turnaround.

We have more than 2,200 members including accountants, lawyers, bankers, academics and other related professionals.

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“Expansion” of EDR to Financial Ombudsman’s Service is Not Appropriate

ARITA rejects the proposition that EDR schemes must be “expanded” to include investigative accountants and receivers. We note the use of the phrase “expanded” as opposed to “created”. We take that to imply the use of the Financial Ombudsman Service (FOS) and we reject that approach.

In the first instance, FOS has no expertise in the areas of insolvency or investigative accounting and should therefore not be called upon to adjudicate matters beyond its expertise. Nor is it appropriate for it to expand its expertise into these areas.

FOS is an entity created and owned by lenders to manage their complaints process. It is not proper, nor reasonable to compel parties beyond those lender-owners into their commercial processes. ARITA made a strong submission to FOS on this matter in September 2016 in reply to its “Expansion of FOS’s Small Business Jurisdiction – consultation paper”. You will find much of our response to this recommendation mirrors that reply, which is also provided here for your information.

Role of Investigative Accountants

Specifically, in relation to investigative accountants (IAs): there are no grounds to force investigative accountants into an EDR scheme. IAs hold no decision-making power. Their role is to review a business and make recommendations based on the scope of the engagement, usually in relation to its viability and quality, causes of failure or distress and/or to identify inappropriate activities. Their work, in circumstances relevant to this inquiry, is generally commissioned by a lender to assure the lender of the status of their security. There is no contractual relationship between such an IA and the borrower. At the conclusion of their reporting, any dispute about steps taken because of that report is between the lender and the borrower. A dispute about the findings of an IA is not properly the domain of an EDR process as no reasonable outcome of an EDR process could be to direct the IA to alter their professional opinion or recommendation. To do so would compromise the professional standing and expertise of the IA and, likely, trigger significant professional indemnity issues for the IA.

ARITA to trial EDR scheme for registered liquidators including receivers

There are many significant and valid reasons to reject compulsory EDR schemes for registered liquidators including receivers. However, since 2015 ARITA has had, as part of our strategic plan, the intention to develop an ADR scheme to support our members in reducing disputes. Implementation of this was delayed. We emphasise that our planned scheme is voluntary and observes the proper right of the liquidators/receivers to refuse to enter ADR/EDR if they feel it conflicts with their statutory obligations or it would result in an unreasonable burden or impact on creditors (the latter being in line with elements of the *Insolvency Law Reform Act 2016*). We also note that any ADR/EDR scheme would be limited to commercial disputes but would not extend to issues such as validity of appointment etc. Importantly, such an ADR/EDR scheme would be complimentary to ARITA’s existing and extensive complaints and conduct processes, including the enforcement of our Code of Professional Practice.

Where EDR can offer an expeditious and agreed outcome between parties, we see this as a value to our members and, most particularly, to the complainant. While we note that all

ARITA members are currently required to have a complaints management arrangement in place, the value of our ADR scheme initiative comes from the independence of the review.

ARITA will commence a trial of our ADR service in the second half of 2017. The trial will offer both binding and non-binding options to the complainant. The ADR arbitrator will be an independent, eminent person with either legal or insolvency experience whose appointment would be subject to the agreement of the complainant.

In relation to receivers being required to enter an EDR process we provide the following concerns:

Current High Levels of Oversight

We point out that few, if any, other professions are subject to the current levels of oversight and review that registered liquidators are already. Complaints about a registered liquidator, which includes receivers, can be made to ASIC who have a dedicated team of 13 FTE staff and an annual budget of $8.5 million for the purpose (noting that there are just 706 registered liquidators). The recent *Insolvency Law Reform Act 2016* provides an extensive range of additional powers of review of the performance of registered liquidators including the creation of new disciplinary committees and show cause notices.

In addition, all registered liquidators are members of at least one professional association, all of which have conduct and disciplinary review processes. We do note that ARITA does not allow commercial disputes to enter our conduct processes, currently deferring these to courts or other dispute resolution mechanisms, however, we often work informally to resolve such concerns between parties.

Cost to insolvency practitioners of compulsory attendance

Compelling insolvency practitioners to attend or participate in a dispute resolution process would also impose an inevitable cost burden on insolvency practitioners. As with all necessary and proper costs associated with the insolvency practitioner's conduct of an insolvency administration, these will be met out of what (often little) assets remain for the benefit of a distribution (dividend) to creditors.

The costs of insolvency practitioners' compulsory attendance at EDR conferences will become another expense of the external administrations or bankruptcies of small business borrowers, which ultimately will be borne by creditors through reduced returns.

If the EDR process were to take place after the completion of an administration, that insolvency practitioner may be left in a situation where the costs of their involvement in a EDR process, including forgone billable hours, would not be recoverable from the completed administration, leaving the insolvency practitioner without any recourse for costs.

Potential conflict with the customary role and duties of insolvency practitioners

Any new power to compel insolvency practitioners to attend or participate in a EDR dispute resolution process would also be at odds with the independent role and duty of an insolvency practitioner upon his or her appointment to an insolvent business.

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Insolvency practitioners appointed to a small business borrower administer and implement an insolvency law regime for the benefit and the interests of a variety of stakeholders. In liquidations and administrations, the primary stakeholders are all creditors while in a receivership it is usually a secured creditor which has enforced its security interest by appointing a receiver.

The broad powers conferred on insolvency practitioners upon their appointment are exercised subject to strict fiduciary and statutory duties owed by the insolvency practitioner. Liquidators and administrators must generally exercise their powers in the interests of creditors. Receivers exercise their powers in the interests of their appointor (secured creditor), while still owing the company equitable and statutory duties of good faith and reasonable care and diligence.

That all said, creditor stakeholders (or any committee of inspection comprising select creditors) cannot 'direct' how an insolvency practitioner performs his or her functions or exercises his or her powers.

We are also concerned for the implications of any new power on the part of FOS, or any other EDR system that a receiver/liquidator may be forced into, which might potentially compel the production of books from an external administrator or trustee-in-bankruptcy. (Theoretically that would include the Official Trustee in Bankruptcy, the Inspector-General of the Australian Financial Security Authority, meaning that FOS would be seeking the power to compel the participation of a government agency). Relevant legislation presently provides for restricted rights of access to the books which an insolvency practitioner is required to keep during the conduct of an appointment.

For example, s 531 of the *Corporations Act 2001* (Cth) and Regs 5.6.01 and 5.6.02 of the *Corporations Regulations 2001* (Cth) provide for the ability of a creditor (or contributory) to inspect books which a liquidator must keep to give a complete and accurate record of the liquidator's administration of the company's affairs. This right afforded to creditors reflects their usual primacy as a stakeholder in an insolvent liquidation.

Personal Liability

Receivers have personal liability for debts incurred during the conduct of the receivership (ss 419 & 419A). Any EDR could potentially delay decisions on the sale or shutdown of the business to which a receiver has been appointed. We question who is responsible for the ongoing trading liabilities while the EDR process works through, noting the receivers personal liability if trading continues.

Delays

We note that the FOS has become widely used as a delaying tactic. "Pre-insolvency" advisers are well known for providing advice to distressed investors that a referral to the FOS can be used to create a "stay" that allows directors to undertake other activities before a bank can move. We would suggest that this will naturally be extended into the receivership space if it is made available.

Most importantly, delays generally result in increased costs in a formal appointment. Those costs will be borne by secured and unsecured creditors, or a future liquidator who may not be able to even recover their own costs.

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Section 420A responsibilities.

We note that any outcome from the EDR could not override a receiver's s 420A duties and responsibilities around sale of assets. These duties have been clearly reinforced and clarified by the Courts.

Different Roles

Receivers are different to valuers and IAs – receivers are often appointed over the whole of the business, and as mentioned above, they have personal liability for debts incurred and statutory responsibilities during the conduct of the appointment.

A dispute about a valuation will occur after the engagement is complete. No formal appointment of an insolvency practitioner has been made and the directors remain in control of the business.

A dispute about the engagement of an IA does not involve situations of personal liability like a receivership and the IA is not trading the business – during the period of an IA responsibility for issues like insolvent trading remain with the directors.

A dispute involving a receiver will generally occur during the conduct of the appointment and such a dispute will have an impact directly on the receiver and his/her liabilities and responsibilities.

23 September 2016

Financial Ombudsman Service Australia
By email: smallbusiness@fos.org.au

Dear Sir/Madam

Expansion of FOS's Small Business Jurisdiction – consultation paper

Thank you for the opportunity to lodge a submission on the consultation paper 'Expansion of FOS's Small Business Jurisdiction' (Consultation Paper). Our submission refers to only some of the consultation questions, primarily relating to the proposal to ensure that relevant third parties attend FOS 'small business credit facility' (SBCF) dispute resolution conferences.

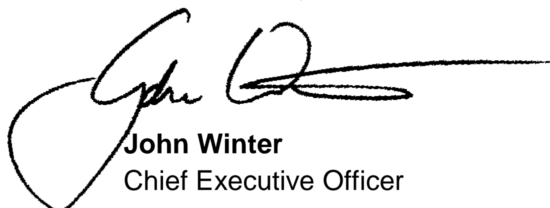
Key points

ARITA submits that Proposal 1.2 to compel 'relevant third parties', such as insolvency practitioners, to be joined to or participate in the FOS dispute resolution process is analogous to the grant or introduction of a power of subpoena. We believe such a power should properly remain in the jurisdiction of the courts, where subpoenas are necessary for the administration of justice and can be supervised by judicial officers in order to guard against potential abuse of process or oppression.

An effective power of subpoena (or its equivalent) is not appropriate for an external dispute resolution scheme. In any event, the proposal would appear to serve little purpose when a FOS process cannot impose any outcome or remedial order against a non-party to a dispute.

Compelling insolvency practitioners to attend or participate in a dispute resolution process would also impose an unreasonable cost burden on the administration of insolvent small business debtors – a cost which ultimately will be borne by creditors through reduced returns and distributions.

Yours sincerely



John Winter
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Proposal 1.2: Compelling the attendance or participation of a relevant third party

Consultation Questions for Proposals 1.1 to 1.3

Do you agree with FOS expanding its small business jurisdiction and Proposals 1.1 to 1.3? If not, why not?

How would the proposals affect your organisation or constituents? Wherever possible could you quantify any costs or benefits anticipated and include examples?

Can you provide other information about the effect of the proposals?

Proposal 1.2 of the Consultation Paper is to '[p]rovide for paragraph 7.3 [of the FOS Terms of Reference] to apply to SBCF disputes in a way that allows FOS, when considering such a dispute, to require a party to [i] attend a compulsory conference and [ii] ensure that a relevant third party also attends the conference.'

Insolvency practitioners of a small business borrower or guarantor are specifically mentioned as one category of third party which, at present, FOS cannot compel to participate in its dispute resolution process. The Consultation Paper also seeks 'any suggestions or feedback about approaches' which could be taken 'to address the limitation on FOS's ability to compel relevant third parties to be joined to or participate in the dispute resolution process.'

At the outset we note that the Consultation Paper is silent as to how the apparent desired outcome of legal compulsion would be implemented or achieved. As reflected in the terms of the Consultation Paper quoted above, it is not entirely clear if the proposal is intended to impose a requirement *on parties* to ensure the participation of a relevant third party, or whether it is being suggested that FOS might be invested with a power to do so.

Either way, we are not sure how third parties (non-parties) could be compelled to attend a FOS process in the absence of enabling legislation which would grant such a power to require attendance.

Equivalent power of subpoena is inappropriate for FOS's external dispute resolution scheme

Any power of FOS (or the parties to a dispute) to compel 'relevant third parties', such as insolvency practitioners, to be joined to or participate in a FOS dispute resolution process would be analogous to a power of subpoena. A subpoena is the power of a court, on its own motion or at the request of a party, to require a person to attend court to give evidence, produce documents or both.

While subpoenas have been described as a necessary power to enable a court to effectively 'carry on the administration of justice', their exceptional nature has been acknowledged as

an ‘invasion of the rights of a stranger’ to a dispute.[1] Importantly, court rules and judicial oversight guard against the potential misuse or abuse of subpoenas. For example, courts may hear objections to – and set aside – subpoenas on the grounds of want of relevance, extraneous/ulterior purpose or oppression.

For these reasons, a power of subpoena (or its equivalent) should properly remain in the jurisdiction of the courts and is not an appropriate power for an external dispute resolution scheme.

In any event, the proposal to compel the attendance of a ‘relevant third party’ would appear to serve little purpose given that a FOS dispute resolution process cannot impose any outcome or remedial order against a non-party to a dispute. This reality is already reflected in the FOS’s own Fact Sheet which details how disputes are handled if the applicant is insolvent.[2]

Cost to insolvency practitioners of compulsory attendance

Compelling insolvency practitioners to attend or participate in a dispute resolution process would also impose an inevitable cost burden on insolvency practitioners. As with all necessary and proper costs associated with the insolvency practitioner’s conduct of an insolvency administration, these will be met out of what (often little) assets remain for the benefit of a distribution (dividend) to creditors.

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Potential conflict with the customary role and duties of insolvency practitioners

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[1] *Summers v Moseley* (1834) 2 C & M 477; 149 ER 849; *Re BLBS and Minister for Foreign Affairs and Trade* (2012) 129 ALD 380 at 392 [32].
[2] FOS Fact Sheet ‘How we handle disputes involving insolvent individuals and small business’ available at https://www.fos.org.au/small-business/fact-sheets/.

in a receivership it is usually a secured creditor which has enforced its security interest by appointing a receiver.

The broad powers conferred on insolvency practitioners upon their appointment are exercised subject to strict fiduciary and statutory duties owed by the insolvency practitioner. Liquidators and administrators must generally exercise their powers in the interests of creditors as a whole. Receivers exercise their powers in the interests of their appointor (secured creditor), while still owing the company equitable and statutory duties of good faith and reasonable care and diligence.

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Relevant legislation presently provides for restricted rights of access to the books which an insolvency practitioner is required to keep in the course of the conduct of an appointment. For example, s 531 of the *Corporations Act 2001* (Cth) and Regs 5.6.01 and 5.6.02 of the *Corporations Regulations 2001* (Cth) provide for the ability of a creditor (or contributory) to inspect books which a liquidator must keep in order to give a complete and accurate record of the liquidator's administration of the company's affairs. This right afforded to creditors reflects their usual primacy as a stakeholder in an insolvent liquidation.

Participation by insolvency practitioners in FOS dispute resolution processes should remain voluntary

Of course, insolvency practitioners can and will continue to consider – on a case-by-case basis – requests by FOS for the practitioner's involvement in any dispute resolution process, in accordance with current practices reflected in the FOS Fact Sheet referred to above.[3]

Insolvency practitioners will assess such requests in the context of their broader role and duties referred to above. As FOS alludes to in its Fact Sheet, if an insolvency practitioner is not prepared to agree to such involvement, and another party is of the view that such involvement is necessary, then a court is the appropriate forum for the matter to be resolved (including potentially by subpoena).

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[3] Ibid.