



ASIC

Australian Securities & Investments Commission

ASIC's approach to insolvency practitioner remuneration

by

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ASIC'S approach to insolvency practitioner remuneration

Good morning and thank you for inviting me here to give ASIC's current thinking on remuneration issues.

Recently, and especially following the *Stockford* decision, there has been many a published word on the subject of fees paid to insolvency practitioners.

Previously there have been public inquiries including the Companies and Securities Advisory Committee *Corporate Voluntary Administrations* (1998); Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake* (2004) and Companies and Markets Advisory Committee, *Rehabilitating large and complex enterprises in financial difficulties* (2004).

The Joint Committee recommended that ASIC work with the professional bodies to encourage the promotion of best practice standards in remuneration charging and in particular the provision of adequate disclosure of the basis of fees charged by insolvency practitioners and on a timelier basis. We are doing this with our proposed Remuneration Guide.

The Committee recommended that a court should have the power to review the remuneration of administrators and deed administrators on the application of ASIC.

Law reform proposals are with Treasury and we are expecting an announcement soon.

As you know, the Corporations Act does not prescribe remuneration levels. It encourages administrators and creditors to reach agreement between them. Since July 2000, the IPAA ceased using your guide to hourly rates and scales and now charge rates in accordance with your own internal cost structures having regard to the complexity and demands of each appointment.

One of the issues that was addressed, but not determined by Justice Ray Finkelstein in the Federal Court in *Korda, in the matter of Stockford Limited* was **whether the approval of prospective fees charged on a time basis amounts to 'fixing' or 'determining' the liquidators remuneration.** Justice Finkelstein held that administrator's remuneration can only be 'fixed' by creditors in a duly constituted meeting of creditors pursuant to s449E(1) of the Corporations Act 2001 or by the Court on the application of the administrator. The Court may also authorise other means of 'fixing' remuneration pursuant to s447A or s447D. Specifically, the Court held that a meeting of creditors has no power to delegate the task of fixing remuneration to a committee of creditors neither in a VA nor by approving a DCA which includes a clause delegating to a committee of creditors. This was the mechanism used in the *Stockford* matter.

You will recall that in that case, ASIC submitted to the court its concerns that:

- KordaMentha drew \$2,421,175.50 in fees from the Stockford administration when not permitted to do so under the Act
- The fees were drawn by KordaMentha without proper approval by the Court or the Stockford group companies as required by the Act;
- KordaMentha drew the fees in reliance on an invalid authorisation granted by the creditors to a Committee of creditors, and approval granted by that Committee.

In his reasons, Justice Finkelstein found that:

- KordaMentha's fees had not been validly fixed under the Act
- Resolutions of creditors of the Stockford group companies were not legally effective because reports sent to creditors by KordaMentha were misleading in several important respects, notably by implying that communications from ASIC to KordaMentha were (incorrectly) wrong in law

- A report compiled by KordaMentha in accordance with s439A of the Act for consideration of creditors at the second meeting of the Stockford group companies creditors, did not adequately explain the rates charged by KordaMentha, nor provided any information which would enable the creditors to determine the reasonableness or otherwise of the proposed KordaMentha rates.

Justice Finkelstein also had a dig at lawyers' fees as well. He warned insolvency practitioners that they stand in a fiduciary relationship with creditors, requiring that they act to obtain the best legal representation at the cheapest rate and closely monitor and scrutinise the fees being incurred.

Following the decision, ASIC wrote to all 759 insolvency practitioners asking them to let ASIC know whether they had received remuneration in voluntary administrations without first ensuring the amount has been properly assessed and fixed either by the creditors or by the court (or in accordance with directions made by the court), as required under the Corporations Act.

All but 16 liquidators with current Part 5.3A administrations have replied. Included in the replies were 108 liquidators with issues falling within the criteria. The majority of administrators advised that they would rectify the matter by holding meetings of creditors. ASIC is in the process of enquiring from these liquidators, how they intend rectifying the non-compliance with a request to advise ASIC on completion. The 16 who did not reply will be contacted to obtain a response.

The IPAA statement of best practice – remuneration: 1 July 2000 does provide assistance on many of the points raised by the Judge.

It states that where remuneration is approved prospectively, an upper limit must be included in the resolution of creditors or committee of inspection. If the amount is not specified, it will be necessary to seek approval for the additional amount.

However, it does differ on the practice of fixing remuneration prospectively by reference to hourly rates, with no time limit or upper limit. The Judge's view is that a fixed percentage scale should be used in most insolvencies which are not complex or large.

ASIC's current thinking

We will welcome your views with open arms when the draft is released for public comment soon.

As a result of Justice Finkelstein's comments, we realised that this was an area where clarification was needed. We have obtained advice from counsel that argues that remuneration cannot be 'fixed' prospectively where a practitioner intends to charge on a time basis. This is the case whether or not the resolution seeking remuneration states an upper limit or 'cap'. ASIC has taken on board this advice and some of it will be reflected in draft policy guidance that will be released for consultation with the profession soon. Ultimately, the issue may need to be determined by judicial pronouncement.

The ASIC guidance on remuneration will explain our interpretation of the statutory provisions and case law that guides the approval, and payment, of remuneration for the work performed by an external administrator and his or her staff on an external administration appointment, as well as best practice procedures for seeking approval of remuneration and payment for remuneration and disbursements.

In the 03/04 financial year, there were 22 complaints received by ASIC concerning the conduct of insolvency practitioners, about remuneration charging. The good news is that this is less than last year.

As *Stockford* is the hot topic I will talk about our views on whether fees can be fixed prospectively when charged on a time basis.

Prospective fee approval has been common practice in Australia. The usual practice is for an external administrator to table a list of hourly

rates at a committee/creditors' meeting and ask committee members/creditors to vote on a resolution that allows the external administrator to draw remuneration based on those rates.

The resolution will usually specify that the remuneration will be calculated at the rates that apply from 'time to time'. An upper limit may or may not be specified in the resolution. Different rates apply to different categories of staff.

In a national firm, different rates may apply to staff located in different geographical regions.

Our present view based on advice is that seeking approval from a committee or creditors for remuneration for work that has not yet been performed, according to a scale of rates, for a quantum of hours that has not been ascertained or justified with or without an upper limit specified does not amount to 'fixing' remuneration in accordance with the Corporations Act.

To overcome any resulting practical difficulties, we suggest that external administrators have the option to:

- Ask a committee, creditors or the court to 'fix' or 'determine' remuneration in a precise amount or according to a formula where all of the elements can be objectively determined. Practitioners may wait until the end of the external administration before fees are fixed or they might seek to have fees fixed at intervals.
- Seek approval from a committee, creditors or the court to draw remuneration on an interim basis at intervals specified in the agreement, resolution or order, up to an agreed maximum amount. At a later stage, ask the committee, creditors or the court to 'fix' or 'determine' the amount of remuneration in a precise amount. If the amount 'fixed' initially or adjusted by review of the court is less than the amount of the interim

remuneration approved and drawn, the proper course is for the practitioner to repay the excess amount.

- Where prospective fee approval is sought, this should only be in cases where a precise amount for the fee can be determined (for example, by a percentage of gross realisations). If practitioners wish to calculate a fee according to time spent on the work, this can be fixed in retrospect in a precise amount and any prospective element can be 'fixed' on an agreed basis (i.e. a fixed fee). In the latter case, committee members, creditors and the court should be fully informed of how this amount has been calculated.

Disclosure

Whatever the methods used in calculating remuneration, be it time-based costing, fixed fees or commission, we expect the practitioner to disclose to creditors or the committee the types of methods that can be used to calculate remuneration and the reason the method chosen is appropriate to the administration. This disclosure should be made prior to the holding of any meeting where creditors or committee members are asked to resolve or agree to fix remuneration.

In relation to time-costing, disclose the applicable rates to creditors as soon as possible after the appointment (including GST).

In relation to fixed fees, table the quoted fee at the first meeting of creditors or include it in the first circular sent to creditors. Disclose the calculation of the fee (including GST), what services are included and an undertaking that the necessary work will all be completed regardless of whether the time taken to complete the work has been over or under estimated.

Where a practitioner intends to charge a fee based on percentage of realisations in an external administration, disclose the flat percentage or percentage scale as soon as possible after the appointment.

Expressly state the services that will be provided.

Contingency fees

We consider it unacceptable for a practitioner acting in a fiduciary capacity, to seek or accept a fee variation calculated on the basis of a contingency. An external administrator is expected to carry out his legal obligations to the best of his ability in the interests of the company without the benefit of an added incentive.

Asking creditors to fix remuneration

Creditors should have before them:

- explanation of the applicable statutory provision
- creditor's rights with respect to approving remuneration and seeking a fee review
- types of methods that can be used to calculate fees
- total amount of remuneration claimed (inc GST)
- summary of the tasks performed (presented as phases of activity with milestones or categories of task)
- summary of the results achieved
- Explanation of any difficulties encountered, unique circumstances or matters that required specialist knowledge.

When might ASIC request a review of remuneration?

Where ASIC has the standing to apply for a review, we may do so where we are of the view that the amount of remuneration that has been fixed is excessive or where a decision was made by creditors or a committee to fix remuneration and we are of the view that creditors or the committee were not fully informed prior to the resolution being put to them.

Disbursements

We think this is an area where further clarification is needed, specifically the demarcation between services included in remuneration calculations and those charged as disbursements. The issue, of course, is that remuneration requires approval and payment for disbursements does not, although committees and creditors may have input into decisions about whether or not to incur particular disbursements. Insolvency firms and larger accounting firms with insolvency divisions might provide a range of services as part of an external administration. Some of these services would be charged as disbursements and some as remuneration. We are looking to provide some statements of principle to assist practitioners to follow best practice and ensure that a consistent approach is followed across the profession.

Legal principles in general relating to remuneration issues

As stated eloquently by West Australian Phillips Fox lawyer David Thompson in a recent article in the *Insolvency Law Journal*, ('Insolvency practitioners Costs: A tough new world') the legal principles governing determination of remuneration have been stated in *Re Solfire Pty Ltd (no 2) (1998) 16 ACLC 1156* and *Venetian Nominees v Conlan (1998) 16 ACLC 1653*.

- Sufficiently detailed information must be provided when asked to 'fix' or 'determine' remuneration, so as to ascertain whether reasonable in the circumstances
- A resolution passed by a meeting of creditors will be invalid if made on the basis of insufficient information
- Identify persons, or grades of persons used in task and the dates

- Enough sufficiency provided so that an interested party may ascertain whether to object
- Item by item analysis similar to solicitor's taxation of costs not required (though taxable form bill provides a good model)
- Onus to prove reasonable is on external administrator
- Ensure staff keep detailed diary notes and time sheets and make available for inspection upon request
- Open-ended resolutions are not valid
- External administrators are not automatically entitled to remuneration for all work undertaken in the course of an administration. Work must be properly undertaken (reasonably necessary to achieve overall purpose of the administration)
- External administrators are given latitude to exercise commercial judgement
- Disbursements claims must have sufficient information to determine whether reasonable and reasonably necessary.

Stockford has added to this list: any creditors' resolution purporting to determine or fix remuneration must be formally valid and an informed resolution before it can have any legal effect.

Detailed, understandable information is the key, and lots of it.

Thank you for inviting me here today and we look forward to consultation on our proposed guidance note.