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INSOLVENCY LAW REFORM ACT 2016 ("Reforms")
INSOLVENCY PRACTICE RULES 2016 ("Rules")

We detail below some observations in relation to the above Reforms.

For the purposes of this newsletter the following abbreviations apply:

1. The senate inquiry means "*the regulation, registration and remuneration of insolvency practitioners in Australia: the case renew framework"*.
2. The Act means the *Corporations Act 2001*.
3. The ILRA means the *Insolvency Law Reform Act 2016.*
4. The IPR means the proposed *Insolvency Practice Rules (Corporations) 2016*.

1. Official Liquidators

There may be an unintended consequence of the loss of the category of "Official Liquidators" under the ILRA.

The Supreme Court in Victoria and the Federal Court maintain a list of Official Liquidators from where a petitioning creditor is able to make enquiries of a practitioner for the purposes of obtaining a consent to act. The Court will only appoint persons from that list and the term "Official Liquidator" is embodied in the Supreme Court (Corporations) Rules (Vic) and the Federal Court (Corporations) Rules. A petitioning creditor can obtain consent from a practitioner ("IP") out of turn but so long as that person is an Official Liquidator.

It is not clear to us under the ILRA as to the process by which the term "Official Liquidator" in the Supreme Court Rules and the Federal Court Rules will be amended.

Our concern is that on or after the commencement date, which is 1st March 2017, the Supreme Court in Victoria and the Federal Court may be met with an objection by a defendant/respondent in a winding up application that the Court has no power to make the winding up Order as the person who has consented to act as liquidator is not an "Official Liquidator" as prescribed by the relevant Rules.

Even if the Order is made or the defect is overlooked there is the prospect that at some later date the liquidator's actions - for instance in realising assets, instituting proceedings or investigations (including criminal prosecutions upon which the evidence of a liquidator may rest) will be challenged on the basis that there is a fundamental defect in his or her appointment.

If the defect is upheld then there will be substantial adverse consequences across the insolvency profession.

In our opinion this issue requires urgent attention

2. Court Winding Up of Solvent Companies

From time to time shareholders/members make application to the Court for the appointment of a liquidator pursuant to Part 5.4B of the *Corporations Act 2001* on the basis of an oppression by the majority, breach of duty by directors and the like. Further, from time to time due to an oversight by directors a winding up order is made on the application of a petitioning creditor where the company is in fact solvent. This can occur where the company is unrepresented at the hearing.

Our observations of the ILRA and the Rules is that the rights of members in externally administered companies that are solvent (other than a members voluntary) have been overlooked. For instance, there is nothing in subdivision D of Schedule 2 of the Insolvency Practice Schedule (Corporations) that provides the rights of members of such companies to seek information from the liquidator. This omission is repeated in Part 3 – General Rules relating to external administration in the Rules.

There also appears to be no mechanism for members to approve remuneration of companies in such circumstances.

It seems inevitable that creditors will be called upon to approve fees and this is provided for within the ILRA and the proposed Rules.

However this is inconsistent with notions of the alignment of those persons with economic interest being entitled to make decisions that affect those interests that creditors of a solvent company who are entitled to receive full payment of a claim are in effect given de facto control on information flowing from external administrators and their remuneration.

3. Division 75 – Meetings

The difficulties we have foreshadowed above in respect of meetings of members of externally administered (not members voluntary liquidations) continues in Division 75 of the Rules.

There is simply no avenue for members to request a meeting nor for an IP to call such a meeting for the purpose of the due administration of the company or the approving of remuneration.

4. Independence

Much of the senate enquiry and ASIC's more recent activity in respect of investigations of insolvency practitioners ("IP") has been around the question of independence. ASIC has looked at the relationship between IPs and their referral networks and the relationship between IPs, company directors and their associates.

In our observations the question of independence was not a significant issue up until the introduction of the Part 5.3A of the *Corporations Act* ("the Act"), the voluntary administration regime ("VA") which commenced with the *Corporate Law Reform Act 1992*.

Prior to the introduction of that regime the common pathway for the restructuring of the company was via the appointment of an official manager (a relatively rare occurrence) or a scheme of arrangement which often followed the appointment of a provisional liquidator. It was the lack of flexibility in the available approaches that led to the introduction of the VA regime.

That regime however did give the power of appointment to directors and therefore, the choice of IP was very much in the hands of directors whose objectives may have been more aligned with their own interest rather than the interests of the company as a whole.

Also over time there has been a drift away from the Court appointed liquidators being taken on rotation from the Court's lists to a process whereby nominations are essentially in the hands of the petitioning creditors.

Creditors Voluntary Liquidation s ("CVLs") have always commenced with a nomination of a liquidator by the company director(s)/ shareholders, we are not aware prior to the commencement of the VA regime that independence in CVLs was a significant issue.

Of course there is also the change in the dynamics of the make up of unsecured creditors over this period.

In our observation before the introduction of GST and SGC regimes, whilst the ATO was often a significant creditor there was often a body of ordinary trade creditors which had a mitigating effect on the IP in CVLs.

With the introduction of the ILRA, the category "official liquidators" has been abolished and it seems that there will be the abolition of Court list and its rotation process.

It occurs to us that this is heading entirely in the wrong direction. Independence is of critical importance and in our opinion one way of safeguarding independence would be for all appointments to be taken on a rotating basis so that the market for a "friendly liquidator" would immediately evaporate.

Practitioners on such a list (operated by ASIC) would simply consent on the basis of a potential conflict of interest, inability to take on additional work due to other commitments or that the profile of the job is outside their firm's capabilities i.e. interstate, too large or a particular industry of which the IP is not familiar.

5. **Registration and Renewal of Registration**

5.1 The IPRs introduce a regime for registration and renewal of registration.

In our observation, the requirements of the IPR entrenches the pathway to registration that has been in place for many years.

We note that the senate inquiry at recommendation 13 provided as follows:

> *11.55 The committee recommends that section 1282(2)(a)(i) of the Corporations Act is amended to read:*
>
> *……is an Australian legal practitioner holding a current practising certificate with at least five years' post administration experience as a practising commercial lawyer; and/or*
>
> *……holds a Master of Business Administration with at least five years' commercial experience.*

In its introductory paragraph to that recommendation (paragraph 11.54) the committee observes:

> *"The committee believes that the best way to resolve the problem of overcharging and over servicing is to open the profession to more entrants. Presently, the requirements of registration as a liquidator are a course of study in accountancy of not less than three years and a course of study in commercial law of not less than two years. The committee believes the profession should also attract applicants with suitable experience from the legal profession as well as applicants with a Masters in Business Administration and relevant commercial experience. The committee emphasizes, however, the importance of a written examination to screen the wider range of applicants (see recommendations 8 and 9).*

We fail to see how registration can be obtained other than from within a firm presently taking appointments as external administrators.

The point here is that in our observation the IPs that have been subject to banning orders or enforceable undertakings over the last 4 or 5 years have all come from this traditional pathway which now seems more entrenched than less so.

Further S20-20 of Schedule 2 of the ILRA does not direct that applicants must come from such a narrow cohort and to this extent the Rules are inconsistent with the ILRA.

5.2 **Regional Areas**

We question whether these requirements will also provide difficulties for practitioners in regional areas.

It is unlikely that even in substantial regional areas in Australia there will be sufficient work for a practitioner to be fully engaged in insolvency practice. It is therefore unlikely that a person from a regional area will obtain 4000 hours experience in the immediate prior five years.

Further, in our observation it is unlikely that applicants who obtain that experience in the major cities will move to regional areas to provide that service. Their skill set would leave that person ill equipped for the diversity of practice in regional areas.

6. **Impact on career paths particularly for women**

We think registration requirements will place substantial difficulties for women trying to become and then maintaining their IP status, whilst trying to juggle family obligations. Many career paths for professional women involve substantial commitment to their work through their 20's and into their early 30's and an element of discontinuance occurs whilst they raise children, perhaps for a period of 3 – 5 years. During this time some work is undertaken but quite obviously not at the same intensity as prior to taking leave. Thereafter there is an ability to return to the workforce.
Today there are family arrangements where men do the child rearing but again inevitably there is a break in the career path.

In our observation both the registration requirements (4000 hours in the immediate prior 5 years) the number of new appointments (3) required in each year and the ongoing CPE obligations will be an impediment to women obtaining and then maintaining their registration.

Obviously, people's capacities and own circumstances vary significantly but it seems to me that the Rules as they currently stand, present a difficulty to an individual who has stepped out of a full time career to assume family responsibilities. The requirement to then restart the whole process upon moving back into the full time work force at a practical level needs re-thinking.