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Dear Sir or Madam

SUBMISSION PAPER - REMUNERATION FRAMEWORK FOR INSOLVENCY PRACTITIONERS

Attached by way of formal submission is a paper I have written together with Richard Fisher AM, Adjunct Professor in the Faculty of Law of the University of Sydney. We make our submission in light of our respective extensive professional experience, Richard as a lawyer and mine as an accountant, in many of Australia's most complex insolvencies. Richard was, you will appreciate, Commissioner of the Australian Law Reform Commission between 1986 – 1989, and involved in the preparation of the Commission's *General Insolvency Report*, number 45 (the Harmer Report). I am now Chairman of BRI Ferrier and have for many years been a co-author of the Australian Insolvency Management Practice Manual.

The "*Proposals paper: A Modernisation and Harmonisation of the Regulatory Framework applying to Insolvency Practitioners in Australia*" published by the Australian Government in December 2011 addresses the Remuneration Framework for Insolvency Practitioners. The Paper observes (at para 59):

> *"It is important that the remuneration framework appropriately empowers creditors on issues of remuneration as it not only affects the returns available to creditors, but the confidence that creditors have in the insolvency system as a whole."*

When addressing that question, the Paper focuses on those general arrangements which permit the effective oversight by creditors of the remuneration which insolvency practitioners are able to charge.

A further issue presents itself where secured creditors can exercise a vote as such and thereby influence the amount of a voluntary administrators' remuneration. This was a circumstance which

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was considered recently by Justice Finkelstein in *Commonwealth Bank of Australia v Fernandez (2010)* FCA 1487. As his Honour acknowledges, such a circumstance gives rise to legitimate concerns on the part of a company's general body of creditors both about the independence of the administrator and about the integrity of the insolvency processes.

In that case, his Honour was able to resolve the issue by removing control of the Administrator's remuneration from the company's creditors and requiring applications for approval of remuneration to be made to the Court. The adoption of that approach in all cases would adversely impact the streamlined nature and cost efficiency of the voluntary administration regime which is and should be one of its great attractions.

The **attached** Submission explores the relevant history of the development of the voluntary administration regime and concludes that the appropriate approach to addressing this issue is the adoption of the recommendation originally made in the Harmer Report; namely, that, if a secured creditor votes at a meeting of creditors in the course of that regime, the value of its vote should be limited to that part of its claim which is unsecured.

It is submitted that, in addition to the other reforms proposed in Chapter 4 of the Proposals Paper, this further reform should be adopted. Such a reform would ensure that the interests of secured creditors were aligned with the general body of a company's creditors. Indeed, if the votes of secured creditors are not limited in this way, it leaves the potential to frustrate the achievement of the beneficial effect sought to be obtained from the introduction of the other reforms identified in the Proposals paper.

Should you have any questions with regards to the submissions, please do not hesitate to contact the writer on 02 8263 2300.

Yours sincerely

Ian Ferrier AM
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Voluntary Administration

Independence of Administrators – Implications for the Remuneration Framework for Insolvency Practitioners

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Introduction

"*The impartiality and independence of administrators are cornerstones of the voluntary administration procedure*". This was the Australian Government's response in 2005 to Recommendation 1 in the Report dated June 2004 of the Parliamentary Joint Committee on Corporations and Financial Services; "*Corporate Insolvency Laws: A Stocktake*" ("***PJC Report***").

That recommendation reads:

> "*3.58 The Committee recommends that the law should require administrators to make available a statement of independence before the first meeting of creditors disclosing any professional, personal or business relationship between the administrator or his/her firm and the company or its officers, members or creditors. There should be provision for appropriate sanctions for false or misleading statements.*
>
> *3.59 Further, the Committee recommends that the administrator be under an obligation to disclose conflicts of interest if and when they arise.*"

The Courts have emphasised that it is not only the fact of an administrator's impartiality and independence but the appearance of impartiality and independence which is important. So, e.g., in *Advance Housing Pty Limited (in liquidation) v Newcastle Classic Developments Pty Limited* (1994) 14 ACSR 230, Santow J said:

> "*… it illustrates the scope for problems that may arise by reason of this aspect of the past dealings between* [the liquidator's firm] *and the* [plaintiff]. *This is with the result that, though nothing before me indicates that* [the liquidator's firm] *have not acted with perfect probity, nonetheless there is not that necessary appearance of absence of conflict. That in turn may lead to a reasonable apprehension that the liquidator may be impeded or inhibited from taking actions that might otherwise be taken in the interests of all creditors or would not take them with the necessary degree of impartiality.*"

That consideration is central to maintaining the confidence of the company's general body of creditors in the integrity of the administration process.

The need for creditors to have that confidence has been recognised most recently in the *"Proposals Paper: A modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia"* published by the Australian Government in December, 2011. Paragraph 59 of that paper, reads, relevantly,

> *"59. This chapter proposes reforms to the remuneration framework for insolvency practitioners. It is important that the remuneration framework appropriately empowers creditors on issues of remuneration as it not only affects the returns available to creditors, but the confidence that creditors have in the insolvency system as a whole."*

As will be seen below, Mr. Justice Finkelstein in *Commonwealth Bank of Australia v Fernandez* [2010] FCA1487 explored the need for the general body of a company's creditors to be satisfied that the level of the remuneration payable to its administration was not capable of being determined or significantly influenced by an individual creditor; in that case, a secured creditor.

The Requirement of Independence of Voluntary Administrators

The PJC Report is one of a number of reports which emphasise the requirement that a voluntary administrator being independent and being seen to be independent is a paramount consideration for the integrity and efficacy of the voluntary administration regime.

The issue was considered in the report of the Australian Law Reform Commission on the General Insolvency Inquiry, Report Number 45 (the "***Harmer Report***") in which, as will be appreciated, it was recommended that the voluntary administration regime be introduced into Australia's Corporations Law. In paragraph 72 of the Harmer Report, the Commission said:

> "*All of these arguments are variations on the same theme that the independence of the administrator should be ensured, a proposition with which the Commission agrees. However, the proposed procedure contains sufficient safeguards towards ensuring that independence. The aim of promoting the independence of administrators is addressed by the following features of the procedure:*
>
> - *The persons eligible to be appointed as administrators will be registered insolvency practitioners who will be practitioners having appropriate qualifications and experience in insolvency practice*
> - *Certain persons having a close connection with the company cannot be administrators*
> - *The administrator must declare associations with the company and any circumstances which may make it difficult for the administrator to act impartially*
> - *The directors cannot remove an administrator*
> - *A lack of independence of an administrator may be a ground for removal of the administrator by the court.*"

When referring to "*practitioners having appropriate qualifications and experience in insolvency practice*" the Commission cross-referred to that part of its report which addressed the qualifications which it had in mind for those persons who would be eligible for appointment as voluntary administrators. In that regard, the Commission (in paragraph 943, Harmer Report) recommended the establishment of three classes of insolvency practitioners of whom only "Class A" practitioners would be eligible for appointment as liquidators in insolvent liquidations ordered by the Court and for

appointment as administrators under the voluntary administration regime. The Commission said of the membership of that Class (in paragraph 944, Harmer Report) that:

> "*… persons seeking to be registered as Class A Insolvency practitioners would need to be of the highest calibre. They would need to have the respect of and standing within the commercial community because it is likely that only persons with accepted skills and experience will be able to successfully promote and administer a voluntary administration.*"

That recommendation was not accepted when the Australian Parliament responded generally to the recommendations in the Harmer Report concerning corporate insolvency law reform. That response was by way of the *Corporate Law Reform Act 1992*. Given the circumstances considered by the Economics Reference Committee of the Senate in its report dated September 2010 on "*The regulation, registration and remuneration of insolvency practitioners in Australia; the case for a new framework*" (the "***ERC Report***") and, in particular, its conclusion in paragraph 5.58 where it says:

> "*… there are clearly several aspects of the regulatory framework* [for insolvency practitioners] *that could be improved. Given the importance of maintaining community confidence in the insolvency regime, and the potential for stakeholder dissatisfaction from the insolvency process, the committee believes that significant reform should not wait for precise data verifying the presence of regulatory failure.*"

There may be justification for a reconsideration of the recommendation in the Harmer Report. However, whatever one's view on that account may be, both the Harmer Report and the ERC Report highlight the importance of both community confidence and stakeholder confidence in the integrity of insolvency processes. That consideration reinforces the need to ensure not only the actual independence of insolvency administrators but also the importance of ensuring that no question can be raised which gives rise to a suspicion of partiality or bias on the part of those administrators.

A further recommendation of the Law Reform Commission concerned statements by voluntary administrators in which they disclosed conflicts of interest (paragraph 78, Harmer Report). In the draft legislation that accompanied the Harmer Report, the Commission recommended that the declaration address:

> "*(a) any prior or present professional or other association that the person, or that a partner or employee of the person, has had or has –*
>
> *(i) with the company or with a company that is or has been a related company; or*
>
> *(ii) with a member, officer or creditor of the company or of a company that is or has been a related company,*
>
> *in respect of the affairs of the company, so far as they are known to the person, and disclose fully and truly the circumstances of the association; and*
>
> *(b) any circumstances, other than such an association, known to the person that may make it difficult for the person to act impartially as the administrator of the company.*"

That recommendation, likewise, was not adopted in the *Corporate Law Reform Act 1992* but, as will be seen, a similar proposal was subsequently considered and adopted.

In the context of this submission, it is pertinent to note the full text of paragraph 78 in the Harmer Report and, in particular, the passage which is highlighted:

> "*Statements by administrator: conflict of interest*

78. *The administrator will be required to declare associations with the company and any circumstances which may make it difficult for the administrator to act impartially. The South Australian Law Society suggested that it may be very difficult for an administrator appointed by a debenture holder, perhaps after completing an investigation for the company's affairs on behalf of the financier, to be completely impartial* [emphasis added]. *However, if this is the case, such a person should not accept an appointment as administrator. Mr Keenan suggested*

- *there should be a penalty on persons who do not make a true disclosure or who make false declarations and*
- *the declaration should cover a larger group of associates, including related companies.*

The commission has accepted both of these suggestions."

The issue of an administrator's independence was considered again in the report of the Legal Committee of the Companies and Securities Advisory Committee (the "**Legal Committee**") on "*Corporate Voluntary Administration*" which was published in June 1998 (the "***CAMAC Report***"). The Committee put its position succinctly (in paragraph 6.2) as follows:

"*it is important that the administrator either be independent of the company and particular creditors or alternatively the creditors generally be made aware of any relationships between them, given that these relationships could impede the administrator's independence.*"

Having reviewed the submissions it received, the Committee recommended in paragraph 6.9 as follows:

"***Recommendation 36.*** *All administrators (whether appointed under s436A, 436B or 436C [of the CA] should be required to table a statement of interest at the first meeting of creditors. The statement should disclose any professional, personal and business relationships of the administrator and his or her firm with the company or its officers, member or creditors that the administrator knew or should have discovered upon reasonable inquiry, including as an accountant or other professional (other than the relationship arising merely from the company's request that the person be an administrator).*"

As already noted in the introduction, the Australian Government's response to the PJC Report recognised the centrality to any effective insolvency regime of the administrator's impartiality and independence. Indeed, that Report devotes considerable attention to that issue and, in consequence, revisited, in effect, the recommendation of the Harmer Report to which reference has already been made and which contemplated that administrators would have to make a declaration of those associations which may have an impact on both their actual and perceived independence. Indeed, as has been noted in the Introduction, it recommended the need for such a declaration.

That recommendation was adopted by the *Corporations Amendment (Insolvency) Act 2007* which introduced section 436DA into the *Corporations Act* ("***CA***") and, in particular, subsections 2 and 3 of that section which read:

"***436DA(2) Declaration of relationship s and indemnities***. *As soon as practicable after being appointed, the administrator must make:*

(a) a declaration of relevant relationships; and

(b) a declaration of indemnities.

436DA(3) Notification of creditors. *The administrator must:*

(a) give a copy of each declaration under subsection (2) to as many of the company's creditors as reasonably practicable; and

(b) do so at the same time as the administrator gives those creditors notice of the meeting referred to in section 436E.

Relevantly, for the purposes of this submission, it is sufficient to note that section 60(1), CA provides as follows:

"***60(1) Administrator****. In this Act, a* ***declaration of relevant relationships****, in relation to an administrator of a company under administration, means a written declaration:*

(a) stating whether any of the following:

(i) the administrator;

(ii) if the administrator's firm (if any) is a partnership – a partner in that partnership;

(iii) if the administrator's firm (if any) is a body corporate – that body corporate or an associate of that body corporate;

has, or has had within the preceding 24 months a relationship with:

(iv) the company; or

(v) an associate of the company; or

(vi) a former liquidator, or former provisional liquidator, of the company; or

(vii) a person who is entitled to enforce a charge on the whole, or substantially the whole, of the company's property; and

(b) if so, stating the administrator's reasons for believing that none of the relevant relationships result in the administrator having a conflict of interest or duty".

The Explanatory Memorandum which was published with the *Corporations Amendment (Insolvency) Bill 2007* provides the following background:

"*4.68 Under common law, administrators have a duty to avoid placing themselves in a position where they may be subject to a conflict of interest or a conflict of duty. Further, section 448C of the Corporation Act identifies a number of circumstances in which a person must not seek or consent to appointment as an administrator. Notwithstanding the requirements under common law and statute, concerns have been raised about the independence of administrators.*

4.69 For example, there may be a perception of a lack of independence where the administrator earlier acted as an advisor to the appointing board of directors, particularly where the administrator is subsequently required to consider the possibility of offences, negligence or breaches of duty or trust by the current and former directors."

The Capacity to Influence a Voluntary Administration

One of the themes which provides a continuous thread through the discussion on the independence and impartiality of administrators is the requirement that they appear independent. That is to say, it is

not sufficient that they be independent as a matter of fact or that they conduct themselves impartially or independently irrespective of some previous association such as with a director, shareholder or a creditor, it is necessary that they appear to be independent and impartial.

As noted above, this requirement that there be no perception of a lack of independence found expression, as a matter of legislative policy, most recently in the Explanatory Memorandum published with the *Corporations Amendment (Insolvency) Bill 2007* which was cited above.

It is also a requitement which the Courts have consistently imposed upon administrators. In that regard, the observations of Mr. Justice Santow in *Advance Housing Pty Limited (in liquidation) v Newcastle Classic Developments Pty Limited (SUPRA)* which were quoted above are just of one of numerous judicial observations which are all to the same effect.

It is submitted that, at the heart of these expressions of legislative policy and judicial concern, is the recognition that the community at large must have confidence, as a general matter, in the insolvency regime and that, in the context of any particular insolvency administration, the entire body of the company's creditors are entitled to feel every confidence that the administrator is prosecuting their collective best interests and is not acting in the interests of any of, say, the shareholders, the directors, or a particular creditor.

The circumstance that there must be that confidence both generally and in particular insolvency administrations, in turn, is a reflection of both the considerable powers which voluntary administrators are able to exercise and the substantial influence which they can exert on the outcome of a voluntary administration. Without exploring that proposition in detail, voluntary administrators not only manage the company and its business during the course of the voluntary administration but they conduct such enquiries, make such analyses and form such judgements as enable them to advise a company's creditors what, at least in the voluntary administrator's opinion, is that arrangement which is best calculated to promote their best interests. In particular, they are required to review the transactions which the company has undertaken for the purpose of assessing whether any of them could be avoided by a liquidator, what prospects of success might attend the prosecution by a liquidator of any such claim and whether such proceedings would be in their commercial interests.

Additionally to past associations between a voluntary administrator and a creditor, it is submitted that where a creditor, by reason of both the size of its claim and the fact that it holds security, has the capacity to influence either the identity of the administrator or the outcome of an administration in terms of the election between the options available to creditors; namely, liquidation, a deed of company arrangement or the return of the company's management to its directors, that circumstance can give rise to a justifiable lack of confidence in the administrator's independence and impartiality at least on the part of the company's general body of creditors.

In such a circumstance, creditors may be apprehensive on a number of accounts, including:

1. The powers of the administrator to conduct the business of the company might not be used to continue its operational life but rather to realise its assets with a view to satisfying the claims of the secured creditor, particularly where its assets are adequate for that purpose. This apprehension would be felt most keenly by employees and suppliers both of which groups of creditors will have a legitimate interest in ensuring that all reasonable and sensible efforts are made to continue the company's business.

2. Similarly, those creditors may be apprehensive in those circumstances that a less than completely rigorous analysis will be undertaken of the possibility of the company or its business continuing to trade under the terms of a deed of company arrangement.

3. All creditors, other than the secured creditor, will have a concern to be satisfied that the administrator has undertaken a thorough review of the dealings between the company and

the secured creditor with a view to advising creditors generally as to whether any of those dealings might be avoided by a liquidator. Such a review requires not only ascertaining and reporting such objective material as is readily available in the limited timeframe of a voluntary administration but also making judgements which, to varying degrees, will depend on the formation of opinions. Those opinions will relate not only to the prospects of success of any possible proceedings but also the extent to which they may confer an economic benefit on creditors if the company is liquidated. That undertaking will involve some measure of subjectivity on the part of the administrator.

Given the legislative policy considerations and the judicial concerns which are directed to ensuring that administrators are seen to be impartial and independent, it is submitted that the voluntary administration regime should be so structured as to mitigate the apprehensions which have been identified above.

Such an outcome could be achieved, or at least advanced, if the arrangements for voting at meetings of creditors convened under the voluntary administration regime only permitted secured creditors to vote for so much of their debt as was unsecured.

That arrangement would be consistent with the recommendation of the Harmer Report which was to the effect that the rights of secured creditors under the voluntary administration regime should be the same as then applied under Part X, *Bankruptcy Act* (para 113, Harmer Report). The then provisions of that Act were section 198(5) and (6) which read:

> "*198(5) Except as provided by subsection (6), a secured creditor is not entitled to vote in respect of secured debt unless he surrenders his security.*
>
> *198(6) A secured creditor may, if he has furnished to the chairman, in writing, particulars of the security and of the value at which he estimates it, vote in respect of the balance (if any) of the secured debt after deducting the value at which he has estimated the security.*"

Those provisions have been replaced by section 64ZA, *Bankruptcy Act*, which are to the same effect.

That recommendation was not reflected in the *Corporate Law Reform Act 1992* for reasons which are not discussed in the Explanatory Memorandum or elsewhere.

As appears from the CAMAC Report (para 3.26), the Legal Committee of the Companies and Securities Advisory Committee in the discussion paper which it published prior to the preparation of that Report "*took the tentative view that the value of a secured creditors debt for determining a majority by value in voluntary administrations should be the same as in other insolvency administrations, namely, the value of the debt after deducting the value of the security. If this change were made, secured creditors would only be able to vote for the full value of their debts by surrendering their security.*".

The Report continues (at para 3.30) and notes:

> "*3.30 Most respondents strongly opposed the proposal, for the following reasons.*
>
> - *Secured creditors are in a strong position to determine the future of the company. If they are to support the administration procedure, particularly through to deeds of company arrangement, the process must offer them an equally strong inducement.*
> - *As voluntary administration is a procedure for companies to reorganise their affairs efficiently and cost-effectively, it should include secured creditors in the decision-making processes.*

- *Any dilution of secured creditors' rights would result in additional appointment of receivers during the 10 business day decision period, especially where secured creditors perceive that they may be in a relatively weak position at the major meeting, and unable to influence the terms of the deed.*

- *The assets over which the secured creditor has security will be used by the administrator. A secured creditor should have a voting power that reflects its stake in those assets.*

- *A deed is meant to be conducted for the benefit of creditors as a whole, whereas a liquidation is specifically aimed at making a distribution to unsecured creditors. The restriction on secured creditor voting in a liquidation should not apply to deeds of company arrangement.*

- *A secured creditor can vote to be bound by a deed of company arrangement, in contrast with Part X of the Bankruptcy Act.*

- *When a company is under a deed of company arrangement, the court has a power to restrain a secured creditor's exercise of its rights.*

- *The value of the security may fluctuate throughout an administration, depending on the nature of the security, and the assets secured. In those circumstances, a creditor may have greater voting power at some times than at others. A vote during a meeting could itself affect the value of one creditor's security.*

- *The value of a secured creditor's security, however determined, may be equal to or greater than the debt secured, in which case that creditor would have no vote, even though the decision may affect the value of the security.*

- *To require a secured creditor to rely on the value assigned to a security, for instance at the date of the appointment of the administrator, may have a serious adverse impact on that creditor's rights during the administration, without that creditor having recourse to any revaluation.*

- *To allow an unsecured creditor with a medium debt to determine the course of the company during an administration where there is a secured creditor with a much larger debt, but a smaller net position, would be inequitable.*

- *In a liquidation, the secured creditor ranks only for the unsecured portion of its debt, but has the ability to deal with its security. By contrast, in voluntary administration, the secured creditor may not be able to deal with its security, but may be unable to protect that security by voting.*"

The reasons are set out in full because it is to be noted that, without undertaking a detailed analysis of each of them, they focus on the position of secured creditors without proper and due regard being paid not only to the position of a company's other creditors but much more significantly the consideration that:

> "*the impartiality and independence of administrators are cornerstones of the voluntary administration procedure*".

This consideration, as will be recalled, was the then Commonwealth Government's response to Recommendation 1 of the PJC Report and was referred to in the Introduction.

The CAMAC Report gave significant attention to the reasons advanced by respondents for not departing from the arrangement which permitted secured creditors to vote for the full amount of their claims irrespective of the value of their security. A consequence of that approach appears to have been that the Legal Committee did not give any or any detailed consideration to the circumstance of unsecured creditors if that arrangement was to continue. Accordingly, there was no or, at least, no transparent balancing of competing arguments as part of the process by which the Legal Committee came to its final recommendation.

For these reasons, at least, it is submitted that the Legal Committee when formulating the CAMAC Report misdirected itself when it decided, in the face of these reasons, to depart from the tentative view which it had formed and to recommend the status quo; namely that secured creditors should be able to vote for the full amount of their debts in meetings while the company is under administration or under a deed of company arrangement.

Beyond that, though, the Legal Committee failed to pay any attention to the logistical and statutory protections which are otherwise available to secured creditors, particularly those holding fixed and floating charges over all the present and future assets of the relevant company. Creditors in that circumstance, in addition to being able to vote for the full amount of their claims, can otherwise have a significant influence on both the identity of the administrator and the outcome of a voluntary administration having regard to the following matters:

1. As a practical matter, the directors of a company who are considering the appointment of a voluntary administrator or the putative voluntary administrators themselves will consult the secured creditor prior to an appointment being made both to ensure the secured creditor has advance notice of the proposed appointment and also to ensure that the proposed appointee is agreeable to the secured creditor.

2. The secured creditor can vote at the first meeting of creditors and, subject to the size of its claim, can have a significant influence on the decision as to whether or not the voluntary administrator appointed by the directors should be replaced.

3. If the outcome of the first meeting of creditors is not agreeable to the secured creditor, it can still exercise its rights to, say, appoint a receiver to the company's assets as the decision period will not have expired.

4. A practice has grown up under which secured creditors, prior to the expiry of the decision period, will agree with the voluntary administrator not to enforce its security for the time being, subject to the voluntary administrator issuing a consent under section 440B upon which the secured creditor can rely even after the expiry of the decision period in the case of secured creditors with a charge aver the whole or substantially the whole of a company's assets.

5. As with the first meeting of creditors, the secured creditor can vote at the meeting of creditors convened to decide the company's future and, again, subject to the size of its claim, can have a significant influence on whether the company is wound up, executes a deed of company arrangement or returns to the control of its directors.

6. Again, if the outcome of the meeting to decide the company's future is not agreeable to the secured creditor, it can still exercise its right to, say, appoint a receiver to the company's assets unless it has agreed to be bound by a deed of company arrangement should the company execute such a document.

It is submitted that all of these considerations should have been put into the balance by the Legal Committee when deliberating upon the recommendation which it would make as to whether secured creditors should be able to exercise voting rights at meetings convened during the course of a voluntary administration or under a deed of company arrangement. It failed to do so.

The Capacity to Influence a Voluntary Administration's Remuneration

The question of whether a secured creditor should be able to influence the appointment and, possibly the conduct, of a voluntary administration was considered recently and since the publication of the CAMAC Report by Mr. Justice Finkelstein in *Commonwealth Bank of Australia v Fernandez* [2010] FCA 1487. That case involved, amongst other things, an application by the plaintiff bank, which was a secured creditor of the relevant company, to remove the voluntary administrator appointed by the company's directors and appoint the bank's nominees. As his Honour recognised, such an application involved an assessment of not only the actual but also the apparent independence of the bank's nominees.

As to the conflict between the interests of a secured creditor and those of the general body of a company's creditors, his Honour said:

> "*86. What should I make of the fact that they are the banks' nominee? The context in which the issue arises is this: In an insolvency the interests of secured creditors will not always be coincident with the interests of other creditors. Usually this will be for the reason that a better outcome will be produced for a secured creditor if it can get rid of interests over assets that other creditors may claim. More especially is this so with managed investment schemes. The investors (here the growers) have an interest in scheme assets that are acquired with pooled money. The banks will likely seek to minimise the growers' interests in order for them, as secured creditors, to maximise their own return.*
>
> *87. Accordingly, it will be necessary for the administrators to tread a very careful course between the two groups.*"

His Honour, by recognising that the interests of a secured creditor "*will not always be coincident with the interests of other creditors*", acknowledges the legitimacy of the concerns of those other creditors to the extent that they may be apprehensive about the independence of a voluntary administrator either appointed by a secured creditor or, it is submitted, whose conduct of the administration may be influenced by the secured creditor.

That influence is capable of being exercised both directly and indirectly. Indirect influence may be exercised, at least in the case of secured creditors who hold security over the whole or substantially the whole of the company's property, by them appointing a receiver in the course of the "*decision period*" and thereby removing control of the company from the voluntary administrator. Moreover, as has already been noted, a practice has grown up whereby secured creditors in that circumstance will agree with voluntary administrators not to appoint a receiver on the condition that the administrators give consent to the making of such an appointment at any time during the course of the voluntary administration notwithstanding the expiry of the "*decision period*". That practice reinforces the indirect control which those creditors are able to exercise.

More generally, secured creditors can exercise indirect influence or control by refusing to support any proposed deed of company arrangement which has as its objective the preservation either of the company or of its business.

As to direct influence, secured creditors can bring influence of that kind to bear by the position which they adopt in relation to an administrator's claim to remuneration. Whilst, of course, those creditors can be as cost-conscious as the general body of the company's creditors, they can also afford to be generous in their approach because, subject to the value of their security, they will not have to bear the cost of the administrator's remuneration.

As Mr. Justice Finkelstein acknowledged, at least inferentially, the capacity of secured creditors to influence the amount of a voluntary administrator's remuneration is a legitimate basis for the general

body of a company's creditors both to have a concern about the administrator's independence and to have a lack of confidence in the insolvency system.

All of that said, in the case before his Honour, he was able to satisfy himself that such a concern was not well founded. However, he was only able to do so after both a close examination of the relationship between the bank and its nominees as well as by imposing conditions on the way in which those nominated administrators would conduct themselves in that capacity.

Of course, the close analysis which, as will be seen, His Honour was able to undertake is not an available option in the ordinary course of voluntary administrations unless the courts are to play a greater role in supervising their conduct. Such an arrangement would defeat a major objective of the proposal for the introduction of the regime; namely, the need for a streamlined and cost-effective insolvency process in which the courts did not have a necessary role.

So far as concerned his Honour's examination of the relationship between the bank and its nominees he said:

> "*88. Insofar as the objection is that Messrs Carson & Crosbie will not be seen to be independent, and there is a group of growers who do not regard them as independent, I have satisfied myself that, when looked at objectively, such a view is misplaced. First, the Willmott Growers Group believes Messrs Carson & Crosbie will do a good job. Second, the work they have undertaken for the CBA in connection with the Willmott Forests group should not, in light of the current practical approach to these appointments, be seen to be disqualifying. Third, I will require Messrs Carson & Crosbie to appoint independent lawyers (ie lawyers that are completely independent of the banks) and that should strengthen the appearance of their (the administrators') independence.*"

As to the conditions to be imposed on the appointment of the nominees, Mr. Justice Finkelstein observed:

> "*92. Although satisfied about the proposed administrators; independence, I was not inclined to appoint them without further information. In particular I wanted to know: (a) On what basis would Messrs Carson and Crosbie charge fees and expenses for the work they perform. I specifically requested details regarding the rates proposed to be charged, an estimate of the number of persons who would be involved in the administration, a justification of the proposed fees and expenses by reference to those charged by other insolvency practitioners undertaking similar work, the type of work Messrs Carson and Crosbie and their staff were likely to perform and how long it would take to perform that work; (b) What insurance cover was held by Messrs Carson and Crosbie and the employees of PPB who might work on the administration; (c) On what basis Messrs Carson and Crosbie would select and retain solicitors to assist them in connection with the administration; and (d) Whether Messrs Carson and Crosbie would give an undertaking that they would not, without leave of the court, retain as the solicitors of any Wilmott company a firm on the CBA's or St George's panel of solicitors*."

Whilst his Honour acceded to the bank's application and appointed its nominees as voluntary administrators, he did so only after being able:

(a) to consider detailed evidence as to their actual independence as well as to hear submissions from various of the interested parties; and

(b) to impose conditions including both by exercising the Court's power under s447A CA to modify the operation of s449E so as to require that the administrators' remuneration could

only be approved by the Court (thereby precluding the possibility that the bank could exercise its voting influence when it came to the determination of that matter) and by requiring the administrators to give an undertaking that they would not retain as legal advisers any firm of solicitors on the bank's panel of solicitors.

The importance of these matters is that they were recognised by the judge as constituting, when taken collectively, a safety net both to protect the interests of the company's general body of creditors and to assuage any legitimate concerns which those creditors may have about the independence of the administrators. Such protections would not be available to creditors in the ordinary course of an administration.

Indeed, if the benefits of the voluntary administration regime, in terms of its streamlined structure and cost-efficiency, are to be maintained these protections should not be available in the ordinary course. They would be available, however, if the recommendation in the Harmer Report about limiting the voting rights of secured creditors to the amount of their unsecured claim was adopted. Such a reform would align the relevant interests of secured creditors with the general body of a company's creditors.

One of the matters to which Mr. Justice Finkelstein gave attention when considering the arrangements necessary to secure the actual and apparent independence of the administrators was the procedure to be used when setting their fees. His Honour said:

> "*95 While the rate of fees is reasonable, I propose for the fees to be determined by the Court. Ordinarily, an administrator's remuneration is fixed by the creditors' committee of the creditors. The court only steps in if agreement cannot be reached at that level. In this case I will, pursuant to s447A, vary the operation of s449E so that the administrators' remuneration, unless otherwise ordered, will be set by the court. If it transpires that the court's role is unnecessary and it is best to leave the determination of the fees to, say, a creditor's committee, appropriate orders can be made.*"

As has already been said, it is reasonable to conclude, at least inferentially, that the issue which his Honour sought to address by the establishment of this regime was the perception, if not the actuality, that the bank which had nominated the administrators could not influence both the level of their fees and, by that indirect means, their conduct of the administration.

This touches an issue which was of critical interest in the ERC Report. As it noted; *"this inquiry has raised questions about the adequacy of current arrangements to monitor both an individual practitioner's fees and the fee structure of the insolvency industry at large."*

The concerns of the Economics References Committee on that account sounded in at least two recommendations; one dealing with the suspension of a liquidator's licence if it is believed that there has been overcharging and the other to better facilitate the removal of a liquidator (and, presumably, an administrator) who had lost the confidence of a "majority of creditors".

Those recommendations reinforce the conclusion of Mr. Justice Finkelstein that one consideration which will impact on the actual and apparent independence of administrators is the capacity of a creditor to influence their remuneration and the consequential impact on the confidence of creditors in the insolvency system as a whole. That is to say, the insolvency regime should not enshrine by its operation the adage "he who pays the piper (or, at least, he who determines the piper's pay), calls the tune".

Submission

For all of these reasons but, most importantly, the need to have regard to the cornerstone of the voluntary administration procedure; namely, the impartiality and independence of administrators, the same voting regime as applies in all other administrations should also apply to the voluntary administration regime. That is to say, a secured creditor should only be entitled to vote at a general meeting of creditors concerned in the course of a voluntary administration in respect of so much of its claim as is unsecured and having valued its security. Not only would that harmonise the voluntary administration regime with all other insolvency regimes, it would be consistent with the recommendation of the authors of the regime and the tentative view formed by CAMAC.

In the context of the current Proposals paper, as the analysis of Mr. Justice Finkelstein in the *CBA v Fernandez* case demonstrates, it is a reform which would further address the premise on which the proposed reforms to the remuneration framework are premised:

> "*This chapter* [Chapter 4] *proposes reforms to the remuneration framework for insolvency practitioners. It is important that the remuneration framework appropriately empowers creditors on issues of remuneration as it not only affects the returns available to creditors, but the confidence that creditors have in the insolvency system as a whole.*"