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INSOL's remuneration Report – another perspective

Insolvency practitioner remuneration is the subject of much comment and analysis, but not enough. It is examined only as a service fee of the IP for the administration of insolvent companies, drawn from the remaining assets of the insolvent.

It needs to be seen and assessed in a wider context, involving at least four questions in particular:

i. ***Given that many or even most insolvent companies have few if any remaining assets, to what extent is remuneration, for work done by the IP that is necessary and proper, in fact able to be drawn for that work?***
ii. ***Given that some work of an IP is done on behalf of the state, in the public interest, should it be funded from the remaining assets, or funded by the state?***
iii. ***given that IPs do make money from insolvencies, are their losses recouped from higher charge out rates on paying estates, creditor indemnities, government funding, or other means? and***
iv. ***to what extent does the law require an IP to do work for no fee?***

The following is a work in progress analysing IP remuneration and its associated issues.

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INSOL International has published a commissioned report - *Corporate insolvency practitioners, ethics and remuneration: Not a case of moral bankruptcy?* – by Dr Lézelle Jacobs. It provides a detailed analysis of the usual issues found in the literature, cases and reports about insolvency practitioner (IP) remuneration.

Like many such reports, it prompts a broader context to explain, as to the financial viability of the insolvency system itself, which is dependent on remuneration.

Remuneration, or work done

Any insolvency system must be paid for in some way. Insolvency typically relies upon the funds that are assumed to be available in the remaining assets of the insolvent estate. That is an unwarranted assumption in most cases. Nevertheless, the primary issue is that certain work needs to be done in winding up an estate. Remuneration merely seeks to reflect a price for that necessary work properly done.

Most analyses, like INSOL's, focus on the apparent end result of the work done, being the amount of the remuneration claimed by the IP. Another focus would be to see what work was and had to be done by the IP according to the law, and then see what remuneration was claimable as the reward for that work.

This will often show that, overall, the amount of work done (W hours) at $R rate and the quantum of remuneration (W x $R) do not marry up, with the latter invariably representing payment for only a proportion of the former ([W x .6] x $R) because the only amount remaining is limited.

In many individual cases, there will be no money remaining. INSOL refers to some suggested solutions offered by UNCITRAL, which has the significant issue of high numbers of MSME insolvencies flowing from the present COVID-19 economic impact. These solutions include a surcharge levied against assets, or on creditors, or on secured assets.

Australian experience

The reality of a lack of remaining funds or assets appears to exist across most jurisdictions, and Australia is no exception. This is apparent in the personal insolvency regulator's recent report in Australia - *Remuneration in the personal insolvency system*, of March 2010.[1]

In giving some prescriptive guidance to bankruptcy trustees about what they can and cannot charge for, AFSA reported that in 2018-2019, in 63% of bankruptcies administered by trustees, no remuneration was recovered at all, with the average annual remuneration drawn in each matter being $4,804; and that only 69% of estates finalised had remuneration drawn in one or more of the 3 years of the bankruptcy; and that in finalised cases where remuneration was drawn, the average total remuneration was $29,532. These appear to show at least that in a high proportion of estates, there was no money to pay for the work done.

That is not to say that there was not substantial remuneration paid overall – of the $230.35 million distributed by 200 registered trustees, the report said that 32.2% was paid in dividends to creditors, and 40% was paid in practitioner remuneration, with the remaining 27.8% comprising trading payments, bank fees and other costs, and government charges. As to the 40%, a fairer figure is to include non-paying estates, in which case remuneration accounted for 25-30% of the receipts, a fairly consistent figure each year.

Hence in many estates, the work of the trustee might have been done, and done well, but whether it was to be charged on commission, hours worked or a multiple of the length of someone's foot, it made no difference – they was no money in the estate to pay, or not enough to pay fully.

That is significant given that Australia has a government Official Trustee available to take assetless bankruptcies, all 85% of them.

In corporate insolvency a similar story emerges, one finding being that liquidators are unpaid for work done in excess of A$45m annually – there are no assets in the company to pay for the work required. Figures extracted by Professor Jason Harris in 2017-2018[2] show that almost 40% of companies entering an insolvency administration had no remaining assets. Returns to creditors were estimated at nil in 92% of cases, again, a consistent figure over time.

These and other figures has led him to say that

> "Australia has a system that is barely supported by the assets of companies that enter external administration, and certainly is not designed to produce meaningful recoveries for unsecured creditors".

This puts the aim of proportionality between remuneration and outcome, referred to in the INSOL and other reports, and case law, in some perspective. It is hardly a relevant issue in most cases. Rather, the figures show that the law imposes a disproportionate requirement on IPs to work for no fee.

[1] www.afsa.gov.au

[2] Corporate insolvency by the numbers, February 2018

Those figures and related figures have prompted me to say that the Australian insolvency system is itself insolvent,[3] or, at least that the system is so lacking in accountability and transparency that we don't know. If it were a business operation, it would be a zombie, and shut down. It has no real way of monitoring its costs and outcomes. The lack of insolvency data in Australia has been the subject of continued criticism since the 1988 Harmer Report.

As much as there are regulator, judicial or government responses to this lack of money, they include that:

- IPs can set higher hourly charge out rates for paying estates with assets so as to make up for the losses. That is, $2R x W.
- liquidators can charge on a "swings and roundabouts" basis, however that term might be interpreted;
- there is litigation funding, including to recover fees; and
- if all else fails, insolvent companies that cannot afford a liquidator can simply disappear off the register.

These are hardly honourable or well calculated mechanisms, on both a policy and a numbers basis, and more.

Insolvency work

And as to the nature of the work done, and the consequent high fees, described by the judge in one recent case as "eye-watering",[4] an eminent Australian jurist, Michael Kirby, has written that

> 'the task of insolvency administration is inherently expensive. Principally this is so because of the intensive nature of the investigation of accounts (sometimes in a shambles and sometimes deliberately deceptive) that the insolvency practitioners must analyse and understand".

That should be read in the context of a lack of real attention in Australia to streamlining the insolvency processes or better using technology. The 2016 reforms were much in favour of creditors, which served to add to the reporting and other requirements. As to technology, we have not only a Rolls Royce system but one based on its original 1906 design.

Public interest work

That is not the end of it. The law in Australia expects IPs to do work in an estate in the public interest; this is so in particular in Australian corporate insolvency where there is no government liquidator. Arguably, much insolvency work is in the public interest, as opposed to the narrow creditors' interests. As the court in *Brook v Reed*[5] explained in the context of the quantum of remuneration, that

> "(t)he number and size of claims and the number and value of assets is an important, but not the only, element ... there are many ways in which costs may be incurred which are not related, principally or even at all, to the assets and liabilities of the estate."

Or as Millett J said in *In re Barlow Clowes Ltd,* after explaining the severe impact an insolvency can have on "many thousands, even tens of thousands, of innocent people", an

> "insolvent liquidation cannot be dismissed as 'just a case about money'."

[3] Paper presented to the Insolvency Academics Group, 24 July 2020

[4] *Octaviar* [2020] NSWSC 927 – the remuneration is in excess of A$26m, for the period 2009-2018.

[5] [2011] EWCA Civ 331; [2011] 3 All ER 743

Even narrowing that public interest concept, Australian liquidators must investigate and report breaches of all laws in Australia in relation to the company and support any prosecution. Bankruptcy trustees have similar obligations. This is claimed to be so even if there are no funds to pay for the work done, which is the majority of cases.

If there are funds available, the so called "creditors' money" is used to fund those investigations, about which, as the INSOL Report says, the creditors complain.[6] Creditors might instead fairly redirect their complaints to the law, rather than to the IP, at least in Australia.

An example - a New Zealand decision

A NZ case illustrates that. In *Five Star Debenture*[7] the Judge noted that NZ$43m in creditor losses through a major fraud would not be recouped. Funds of $330,000 had remained in the companies, but the liquidators claimed all of that in remuneration for work done.

While there was no tangible advantage to the creditors as a result of the liquidators' efforts, the enquiries that they made and the attempts that they made to recover were ones which were properly undertaken such that this was "not in any way a matter for which the liquidators [were] to be criticized. Further, there was a strong public policy requirement that there be a proper investigation of the affairs of the company and the enquiries and investigations which the liquidators undertook were commiserate with that need".

Corporate only?

At this point it should be pointed out, as is evident, that the INSOL Report only examines corporate insolvency, not personal bankruptcy, and it thereby omits a relevant body of case and statute law, and history.

English courts in particular have often usefully explained some of the finer issues discussed here in explaining what may seem to be a high amount an IP's remuneration, in the context of the work the law requires of them, irrespective.

For example,

- "a trustee has no choice but to carry out certain statutory duties and that, in a small bankruptcy, the trustee's costs might appear disproportionately large"[8]; and
- that "there are many ways in which costs may be incurred which are not related, principally or even at all, to the assets and liabilities of the estate"; and
- that a judge "should avoid falling into the simplistic error of simply saying, "How can it be that collecting a debt of £11,000 incurs costs more than 20 times the principal sum?"
  As to which, that may be an answer to a concern of an Australian Judge in a recent case who asked how remuneration and legal expenses of $295,000 could be incurred "in respect of an estate that has only three creditors, whose claims ... total only approximately $98,000"? (Counsel's response was that that this was common in cases where the estate became involved in contested litigation, in that case, the court record showing 12 court attendances or hearings throughout).[9]

[6] [2.1.2]

[7] Five Star Debenture Nominee Limited (in liq) v Five Star Finance Limited (in rec'ship) [2015] NZHC 142

[8] Simion v Brown [2007] EWHC 511 (Ch)

[9] www.fedcourt.gov.au

Then there are other Australian bankruptcy cases, one[10] as to the point that a trustee may sue to recoup her or his remuneration, and not be thereby compromised, the court saying that a

> "trustee does not thereby become disabled from an efficient and, if necessary robust, administration of an estate because his own fees may depend on the outcome".

Australian courts allow IPs to pursue litigation to recover their fees, otherwise

> "liquidators would less readily accept appointment, and litigation funders would less readily fund proper proceedings in liquidation, if liquidators could not recover their remuneration or litigation funders could not recover the funding which they provided".[11]

Regulator role in Australian bankruptcy

In the "only three creditors" decision above, the Court did not need to take its concerns further given that a remuneration review was available, by the regulator.[12]

As to that, in the recent 2016 reforms in Australia, the determination of bankruptcy trustee remuneration was properly passed to the regulator, which has experience in administering estates through the Official Trustee in Bankruptcy. Although not explained by the legislature, it seems that it was thought that the corporate regulator did not have the resources or experience to perform that role. Unlike the UK and NZ, Australia does not have government liquidator. Hence, the courts were left with the task of determining remuneration in default of creditors, or in disputes.

One Judge saw the problem as being "how the liquidators' remuneration can be determined reasonably promptly by the Court, having regard to the competing demands on Court resources".[13]

Apart from court resources being often unnecessarily given over to performing these tasks, the costs of going to court are often rather disproportionate, as are the length of judgments given. The INSOL Report discusses judicial determinations[14] but there are other avenues.

Do IPs have to work for free?

The UK's R3 has said that insolvency is the only profession expected to do its work for free.

To some or a large extent that is accurate, in Australia at least, but there is an 'implementation gap' between the law and the practice.

The is a culture of IPs taking appointments as liquidator or trustee where the asset position or any indemnity is uncertain. With commercial 'luck', the estate may produce much work,

[10] *Boensch v Pascoe* [2007] FCA 1977.

[11] *In the matter of Cardinal Group Pty Limited (in liq)* [2015] NSWSC 1761, citing *Hall v Poolman* [2009] NSWCA 64.

[12] *Singh v Hicken* [2018] EWHC 3277 (Ch)

[13] *Kelly, in the matter of Halifax Investment Services Pty Ltd (in liq) (No 9)* [2020] FCA 925 at [33].

[14] [5.6.2]

with money and assets to pay for it – as one Judge explained, the 'swings and roundabouts' arrangement.

The law itself is less clear but it seems – in a poorly worded corporate insolvency provision[15] – that liquidators do not have to do work other than file their accounts and reports. Nevertheless, to file a report a liquidator has to do investigations in order to complete the report.

There is nothing specific in bankruptcy law but the attitude from both regulators is that certain minimum tasks are required, including to investigate and report offences, regardless. It does not seem though that the regulators pursue any regulatory focus on assetless matters and the extent to which they are administered, or otherwise.

This is one aspect of the distortion that the present arrangements for funding work on insolvencies can produce**.**

Relevance of IP remuneration - do the maths

Creditors can be unfairly led along about IP remuneration. Creditors in an estate with 50 creditors might attend a meeting to successfully challenge $15,000 of the $100,000 remuneration, but that extra $15,000 might add only a fraction of a percentage to their individual dividends. That is not to endorse unfair remuneration, but only to put the creditors' commercial position in perspective. As quoted earlier, the minimum statutory duties in a small bankruptcy, or liquidation, will often not only see the IP's costs as disproportionately large but also often consuming all the estate[16].

Hence, for the INSOL Report to say that use of creditor funds has a "profound effect on the interests of unsecured creditors"[17] is, in my view, and with respect, an adverse mantra stated uncritically and too often. This is apart from the fact that it is the law itself that may well require the use of those creditors' funds for other purposes.

Some other points

The INSOL Report and others like it comment on the perverse incentives for IPs to overcharge but this fails to acknowledge that the same incentives apply in many areas - to the dentist or the car mechanic, or the lawyer, whose advice whether to settle or litigate contains the same different financial outcomes; or the academic, to have as many of their students pass as possible. See Opportunistic and manipulative insolvency practitioners? 14 January 2019.

But the process of approval might be said to be more transparent in insolvency, with many creditors, a regulator, the courts and the media involved, as opposed to a single client.

And the source of remuneration in insolvency is not nearly as secure as in those other professions. It is unpredictable and variable and that in itself can create perverse incentives. How the law should be framed to address that is best assessed by behavioural economists and related experts, and in the same way that tax law design draws on such disciplines. Oversight and discipline are blunt means to regulate remuneration.

And as explained, the law is not morally transparent or coherent with its faint rationalisation that while the law imposes strict rules about the claiming of remuneration in terms of hours,

[15] Section 545. See Keay's Insolvency, 10th ed [10.295]
[16] Simion v Brown [2007] EWHC 511 (Ch)
[17] [5.7]

it will accept higher charge out rates being set – hourly or commission – to be imposed on 'paying' estates to make up for losses on assetless estates.

As to suggesting that IPs take their remuneration *pari passu*, Gross properly argues that the IP comes in after the insolvency has occurred in order to resolve the difficulties, with no agreement to suffer a loss like those of the creditors, and nor should such an outcome be imposed.[18] By what logic in any profession should the expert be required to experience the difficulties of the client? And as R3 has said, in what is the only profession expected to do its work for free.[19]

And as Michael Kirby has also written, following his explanation of insolvency administration being expensive,

> "it is unreasonable to demand that skilled professionals should perform their functions at low cost. Dispute resolution has a cost component. Especially where the disputes are complex and contestable, as many involving insolvency are …'.[20]

It is in the context of its work for developing countries that UNCITRAL has devised some useful fee generating mechanisms.

There are other issues, too many to discuss here, but the personal liability imposed by the law, the comparative higher costs of the legal profession, the lack of attention in Australia to streamlining or better use of technology, and the inherent and unresolved tension between work for public and private interests.

The role of the state

That last point was raised effectively by Paul Heath some time ago in examining the proper role of the state in insolvency.[21] His insolvency thesis was that

> "private functions should be performed by the private sector and paid out of funds otherwise available for distribution among creditors, while public functions should be performed by public officials and paid for out of public funds …".

As he wrote, intended as "the first word on this subject, rather than the last", but there have never been a response.

In my view, that is a central issue that needs to be resolved before giving attention to the question of remuneration.

What do we expect?

That question has been broadened further, as to whether we are expecting too much of insolvency law and practice and its practitioners. It has been said[22] that the insolvency practitioner

[18] *Failure and Forgiveness – Rebalancing the Bankruptcy System*, 1999, Yale University Press, Karen Gross at 151.

[19] *Worth the cost? Insolvency Practitioners' fees: corporate insolvency*, R3, The Association of Business Recovery Professionals, UK.

[20] *Bankruptcy and insolvency: change, policy and the vital role of integrity and probity*, (2010) 22(2) A Insol J 4, Michael Kirby.

[21] Paul Heath, *Insolvency Law Reform: The Role of the State*, 1999 N.Z. L. Rev. 569 (

[22] *Keay's Insolvency*, 10th ed, myself and Jason Harris.

> "acts as a protector of the insolvent company or individual, as an asset recovery agent and asset protector, a commercial investigator and problem solver, a public inquisitor, and then, as needed, a distribution agent. ... [and is] expected to do this with limited or, in some cases, no funds, or where funds are available, in the knowledge that these expenses compete with funds which the creditors might see, unrealistically, as theirs".

In the context of the INSOL Report, the authors continued that

> "the ongoing debate concerning remuneration levels in the profession, and their proportionality to the financial outcomes, might properly be viewed with these considerations in mind".

Other perspectives

Even pulling back from that broad question, what is needed in relation to remuneration comes from other disciplines. Indeed, it is odd that a profession of accountants possessing, it is said, a wide range of business, accounting and financial skills relies upon lawyers to make these sorts of assessments.[23]

Looking at insolvency as a business needed by society, the proper and transparent remuneration of its actors – the profession - is needed in order to allow the system to operate.

At a macro and business level, I have suggested that, on the figures, the Australian insolvency system is insolvent. Funds in rich estates are being used to fund assetless work, with no transparency or accountability.

An examination of the funding of the system is necessary by economists and accountants, to assess, for example, Professor Harris' suggestion that it barely has enough money remaining in the companies that enter external administration to fund its operations.

At present it is a system that eats its own.

Conclusion

To reiterate, many analyses of IP remuneration seem to accept that the work that the law requires them to do is an accepted given, without assessing whether that work is properly a task of an IP, or whether the IP, and the creditors, are unfairly being imposed upon by the state. This has been well put by Paul Heath but has not been answered.

There are at least three things regulators, or the professions, could do to start answering that question.

1. The regulators could require IPs to report on hours spent on necessary work properly done, rather than, or as well as, what work was paid for;
2. The respective government agencies – the Official Trustee/Assignee/Receiver as appropriate – could themselves report on what hours their staff spend on estates, irrespective of any claim they have for remuneration; and
3. The regulators could keep statistics like those maintained in personal insolvency in Australia, that at least allow a comparison each year between receipts, payments, dividends and remuneration, as a collective amount, to show any trends, for example, following law reform.

[23] Including myself in writing this.

INSOL's Report make a valuable contribution at a micro-level; but what is needed is to have insolvency itself sort out what interests insolvency is supposed to serve – public and private - and who does them, to what extent, and who pays.