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# A new era in insolvency practitioner discipline

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## Introduction

The Insolvency Law Reform Act 2016 (Cth) has led to legislative changes in three key areas in respect of discipline and regulation of insolvency practitioners. The legislative changes were intended to improve the investigative, referral and disciplinary powers of the courts, relevant bodies and agencies. First, they laid the legislative foundation for the Insolvency Practice Schedule (IPS)<sup>1</sup> inserted as Sch 2 in the Corporations Act 2001 (Cth) and Bankruptcy Act 1966 (Cth). This changed the substantive legal framework governing the registration and discipline of insolvency practitioners to align corporate insolvency practitioners with the framework regulating bankruptcy trustees. Secondly, a new registration and disciplinary committee regime was introduced in the IPS (Pt 2 committee), based on the disciplinary committee that had existed in bankruptcy. Thirdly, the package introduced, in the IPS and respective Insolvency Practice Rules (Corporations) 2016 (Cth) and Insolvency Practice Rules (Bankruptcy) 2016 (Cth), a series of duties and powers to enable the Pt 2 committee to carry out its functions.

In February 2018, a Pt 2 committee handed down the first Pt 2 committee decision in the referral of a registered trustee by the Inspector-General in Bankruptcy (I-G) to the committee under the new regulatory framework<sup>2</sup> (Pt 2 committee report). The case is significant because it was the first disciplinary matter that demonstrates how a Pt 2 committee has interpreted and applied the statute since commencement of the reforms.

In this case, Ms Thomson, a registered trustee, had been the subject of the Full Federal Court decision in *Young v Thomson*.<sup>3</sup> The judgment largely formed the basis for the subsequent show-cause notice (SCN) issued by the delegate of the I-G. In relation to Ms Thomson's conduct as trustee of the estate of Leslie James Young (Young Estate), the SCN alleged a failure to carry out adequately and properly the duties of a trustee (s 40-40(1)(l) of Sch 2 to the Bankruptcy Act) and failure to comply with a standard prescribed for the purposes of s 40-40(1)(p) of Sch 2 to the Bankruptcy Act.<sup>4</sup>

The I-G can issue a SCN where the I-G is of the belief that any of the matters under s 40-40 of the IPS exist. A SCN seeks an explanation from the practitioner

in writing as to why they should be continued to be registered. If the I-G does not receive an explanation within 20 business days, or is not satisfied by the explanation, they can refer the matter to a Pt 2 committee.<sup>5</sup> The committee must use its best endeavours to make a decision under s 40-55 of the IPS within 60 days.<sup>6</sup> The committee is required to give reasons for its decision in a report<sup>7</sup> and the I-G must give effect to the committee's decision.<sup>8</sup>

This article explores three preliminary issues arising from the case, which will assist the development of the new law. First, it briefly looks at the operation of the SCN. Secondly, it examines how the powers and functions of the Pt 2 committee have been applied to the case. Finally, it outlines the public interest element in disciplinary matters and the importance of transparency and accountability in decision-making and publication of decisions.

## Background to the case

Ms Thomson had been a registered trustee since 2009 with extensive bankruptcy and investigative experience. *Young v Thomson* concerned an appeal by the largest creditor of the estate against the Federal Court's decision refusing to set aside the litigation funding agreement entered into by Ms Thomson as trustee of the Young Estate. The Full Federal Court allowed the appeal and ordered personal costs against Ms Thomson. In doing so, the Full Federal Court was critical of Ms Thomson's conduct in respect of certain events in the administration of the Young Estate. The court found, inter alia, that she had entered into a funding agreement in circumstances where there was a conflict of interest and which was manifestly detrimental to creditors.<sup>9</sup>

On 10 November 2017, the delegate of the I-G issued a SCN to Ms Thomson.

## Show-cause notice

The new SCN is based on its predecessor under s 155H of the Bankruptcy Act. Two significant developments are the expansion of grounds to issue a SCN, and the decision-making powers of the committee. In comparison, the scope of the former provision was quite narrow. It required the discipline committee in bankruptcy to decide only "whether the trustee should continue to be registered or cease to be registered", and no other appropriate disciplinary measures.<sup>10</sup>

Some aspects of the wording of the new provisions should be noted. The grounds for serving a SCN under s 40-40 of the IPS are broad, ranging from breaches of the Bankruptcy Act<sup>11</sup> to failure to carry out duties and functions of a trustee in Australia or a foreign country.<sup>12</sup> Within the Bankruptcy Act, the scope ranges in substance and gravity from administrative errors to breach of trustee responsibilities and obligations. It would be an unsatisfactory outcome of the legislature for SCNs to be issued for minor clerical errors, which would result in unnecessary administrative burden.

The threshold for issuing a SCN is low as the belief need not be reasonable. In the Pt 2 committee report, the SCN set out four grounds and bases for belief as substantiated by the Full Federal Court judgment.

The grounds were as follows:<sup>13</sup>

- failure to take reasonable steps to protect property of the estate (s 19(1)(f), Standard 4.3)
- entry into the uncommercial funding agreement (s 19(1)(j) and (k), Standard 2.3)
- failure to provide creditors with information regarding the extent of investigations in the administration, and failure to allow time to respond and inform creditors of the outcome of the investigations (Standard 2.7(1))
- failure to act with reasonable skill and lack of knowledge and oversight of litigation<sup>14</sup>

On the fourth ground, the I-G had extrapolated this issue from the Full Federal Court judgment. The committee noted the Full Federal Court's criticism of the trustee's conduct related to a specific litigation (the Brookfield litigation). The result was that the term of the SCN was broader than necessary, as it referred to litigation generally. The Pt 2 committee therefore determined its review was confined only to the Brookfield litigation.<sup>15</sup>

It is important to note that the power to convene a Pt 2 committee can only be enlivened based on the I-G's determination made after any explanation to the SCN by the practitioner, as outlined above. In the Pt 2 committee report, the Pt 2 committee was not provided with reasons for the I-G's determination that the practitioner's explanation to the SCN was unsatisfactory. Further there is no statutory requirement under s 40-50 of the IPS for the I-G to give reasons to either the practitioner, or the committee. This is a discretionary power of the I-G to decide whether the explanation is unsatisfactory based on the information put forward.

## Powers and functions of the Pt 2 committee

It was intended that the Pt 2 committee be the primary forum for an expeditious resolution of disciplinary matters, by increasing the speed and informality of

proceedings.<sup>16</sup> This case exemplifies that intention. Following the I-G's referral on 7 February 2017, the committee wrote to Ms Thomson's legal representative on 27 February 2018 advising of the 1 March and 6 March 2018 interviews.

The Pt 2 committee observed that there is no requirement to state the grounds upon which the committee came to a decision under s 40-55 of the IPS. Nevertheless, the committee decided it was necessary to do so, basing its decision upon its findings of the four grounds in the SCN. The detailed consideration given to each finding by the Pt 2 committee in its report is significant. Publishing the reasons upon which the committee based its decision is important to the interests of justice not only to the practitioner, but also to the profession and the wider public. Further, had the committee failed to give reasons for its decision, or provided insufficient reasons, it would be open to Ms Thomson to appeal to the Administrative Appeals Tribunal against the decision of the committee.<sup>17</sup>

In order to make a decision, the Pt 2 committee can make reasonable inquiries of any person for the purposes of making an informed decision, or inquiries that the Chair believes are appropriate for the committee to have sufficient information to make a decision.<sup>18</sup> The committee was assisted in its decision-making by the interview with Ms Thomson over 2 days, the relevant documents from the Young Estate, submissions by Ms Thomson's legal representative and the findings of the Full Federal Court judgment and trial judgment.<sup>19</sup>

The Pt 2 committee found that the trustee had taken reasonable steps in the circumstances to protect property relating to the bankrupt estate, including conducting relevant searches. On the second ground, the committee found the trustee had attempted to contact creditors who were unwilling to fund the litigation. Given the imminent prospect of a hearing, there was time pressure for entry into litigation. Additionally, there was no conflict of interest, and overall the committee found the trustee's decision to enter into the litigation funding agreement was warranted in the circumstances. On the third ground, the committee found the trustee had adequately reported to creditors in terms of content and frequency of reporting, having issued six reports to creditors over the period of appointment. However, the committee agreed with the finding of the Full Federal Court that the trustee had failed to allow sufficient time for creditors to respond to the Notice concerning the funding agreement. The trustee also failed to inform creditors in a timely manner of the outcome of the inquiries undertaken in the administration in respect of the funding agreement. On the fourth ground, the committee found the trustee had

relied on advice of lawyers and counsel and held sufficient qualifications and knowledge of the otherwise complex Brookfield litigation.<sup>20</sup>

## Orders

It is important to note that the Pt 2 committee findings are not inconsistent with the Full Federal Court. The committee's function was to examine the actions taken by the trustee from a conduct perspective. Members are appointed to Pt 2 committees on the basis of their knowledge or professional expertise in one or more fields such as business, law, accounting and the administration of companies.<sup>21</sup> It was relevant to this determination that the committee had an appropriate mix of academic, professional and industry expertise. The committee noted Ms Thomson's extensive background in bankruptcy, the general complexity of the administration and the limited funds of the Young Estate.<sup>22</sup>

This case highlights the potential impact of disciplinary action on the livelihood of practitioners. The Pt 2 committee has wide powers to cancel, suspend or impose a condition on all other registered trustees, prohibiting them from allowing the practitioner to carry out any of the functions or duties of a registered trustee on their behalf — as employee, agent, consultant or otherwise, for 10 years.<sup>23</sup>

In the Pt 2 committee report, the Pt 2 committee decided the trustee should continue to be registered without conditions or restrictions on her appointment. The committee *recommended* that the I-G strongly consider conducting an annual review of up to five of the trustee's files during each of the next 2 years — and that the trustee also be asked to demonstrate that she has met the continuing professional development requirements at each annual review. The committee acknowledged the significant costs order against Ms Thomson and the fact that the criticisms by the Full Federal Court would be on the public record.<sup>24</sup> In the circumstances, the committee found it was not appropriate to publicly admonish or reprimand the trustee.

## Public interest

As with any new regime, there will be public interest in the manner in which the relevant administering bodies exercise their powers, and whether the reforms are achieving their intended objectives. Along with reasons for decisions, the publication of decisions will ensure transparency and accountability of the processes of the Pt 2 committee. It will also provide data that can be gathered and analysed to evaluate the effectiveness of the reforms, and to inform any further legislative change.

This committee also made note of the continued media interest surrounding the conduct of insolvency practitioners since the highly publicised 2009 case of

Mr Stuart Ariff.<sup>25</sup> To this end, it is imperative to ensure accurate dissemination of information. In the Pt 2 committee report, the committee also made orders under s 40-55(1)(h) of the IPS that the I-G publish a media release along with the committee reasons for the decision. This was due to the fact that the trustee's referral to the Pt 2 committee had been reported online,<sup>26</sup> and the case had generally received media attention.<sup>27</sup> This shows public interest in bankruptcy and importantly that the expansion of the new committee powers enables it to have regard to public interest in its decision-making.

The committee's decision illustrates the significant departure from the old regime where the disciplinary committees in bankruptcy were not required to publish decisions, let alone the reasons for those decisions.

## Conclusion

The reforms were designed to strengthen the disciplinary and regulatory oversight of practitioners and ensure a fair, effective and transparent process for resolving disciplinary matters.<sup>28</sup> This case provides early insight into the disciplinary process of the Pt 2 committee. The ongoing publication of committee decisions will give stakeholders confidence in the regime.

This case also highlights the real consideration of practitioners' livelihood as well as the public interest in any outcome. It demonstrates that whilst the committee has wide decision-making powers, this does not mean they will be exercised where doing so would result in duplication of orders of the courts, or orders that are unnecessarily punitive.

Overall, the case serves as a good early example of how a Pt 2 committee has interpreted and applied the statute in a manner which furthers the objectives of the reforms.

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## Footnotes

1. Subsequent references to "IPS" are to the Insolvency Practice Schedule (Bankruptcy), unless otherwise stated.
2. *Report of the Committee convened pursuant to Schedule 2, section 40-45 of the Bankruptcy Act 1966 to make a decision about Ms Louise Thomson, a Registered Trustee* (2018) [www.afsa.gov.au/sites/g/files/net1601/f/thomson\\_committee\\_decision.pdf](http://www.afsa.gov.au/sites/g/files/net1601/f/thomson_committee_decision.pdf).
3. *Young v Thomson* (2017) 253 FCR 191; [2017] FCAFC 140; BC201706911.

4. In addition to the relevant provisions of the IPS, the grounds of the SCN set out alleged breaches of the standards applicable at the time to registered trustees: Sch 4A of the Bankruptcy Regulations 1996 (Cth), titled "Performance standards for trustees (including controlling trustees)".
5. Insolvency Practice Schedule (Bankruptcy), s 40-50.
6. Insolvency Practice Rules (Bankruptcy) 2016 (Cth), r 50-90.
7. Above n 5, s 40-60.
8. Above n 5, s 40-65.
9. Above n 3, at [128].
10. Bankruptcy Act 1966 (Cth), s 155I(1)(a)–(b).
11. Above n 5, s 40-40(1)(f).
12. Above n 5, s 40-40(1)(l).
13. Above n 2, at 3.
14. *Adsett v Berlouis* (1992) 37 FCR 201; 109 ALR 100; BC9203637.
15. Above n 3, at [16].
16. In 2011, the Parliamentary Secretary to the Treasurer and the Attorney-General jointly released an options paper, followed by a proposals paper: Parliamentary Secretary to the Treasurer and the Attorney-General *Options Paper: A Modernisation and Harmonisation of the Regulatory Framework Applying to Insolvency Practitioners in Australia* (2011) [http://archive.treasury.gov.au/documents/2060/PDF/Options\\_Paper20110602.pdf](http://archive.treasury.gov.au/documents/2060/PDF/Options_Paper20110602.pdf); Parliamentary Secretary to the Treasurer and the Attorney-General *Proposals Paper: A Modernisation and Harmonisation of the Regulatory Framework Applying to Insolvency Practitioners in Australia* (2011) [http://archive.treasury.gov.au/documents/2264/PDF/Proposals\\_Paper\\_insolvency.pdf](http://archive.treasury.gov.au/documents/2264/PDF/Proposals_Paper_insolvency.pdf).
17. Corporations Act 2001 (Cth), s 1317B. See also *Mansfield v A committee convened under section 20-10 of the Insolvency Practice Schedule (Corporations)* [2018] AATA 1510.
18. Above n 6, r 50-75.
19. *Young v Thomson (Trustee), re Young (Bankrupt) (No 2)* [2017] FCA 8; BC201701193.
20. Above n 2, at 5–6.
21. Above n 5, s 50-10(2).
22. Above n 2, at 9.
23. Above n 5, s 40-55(g).
24. Above n 2, at 18.
25. *Australian Securities and Investments Commission v Ariff* [2009] NSWSC 829; BC200907495.
26. P Gosnell "Thomson first trustee to be referred under new rules" *Insolvency News Online* 21 February 2018 <https://insolvencynewsonline.com.au/trustee-committee-referral/thomson-first-trustee-to-be-referred-under-new-rules-sc/>.
27. P Gosnell "Veritas's Thomson facing \$250,000 costs order" *Insolvency News Online* 6 September 2017 <https://insolvencynewsonline.com.au/thomson-facing-250000-bill/>; J Fife-Yeomans "Bank slams bankruptcy trustee for running up massive legal bill" *The Daily Telegraph* 16 September 2017 [www.dailytelegraph.com.au/news/nsw/bank-slams-bankruptcy-trustee-for-running-up-massive-legal-bill/news-story/c5eb298b125677f731d94dae1893fbbe](http://www.dailytelegraph.com.au/news/nsw/bank-slams-bankruptcy-trustee-for-running-up-massive-legal-bill/news-story/c5eb298b125677f731d94dae1893fbbe).
28. Explanatory Memorandum, Insolvency Law Reform Bill 2015 (Cth), Ch 9, p 254.