8 July 2008

By email: remuneration@itsa.gov.au

Review of Trustee Remuneration
Insolvency and Trustee Service Australia
PO Box 821
CANBERRA ACT 2601

Dear Sir/Madam

Review of Trustee Remuneration

We welcome the opportunity to comment on the Remuneration of Registered Trustees Proposals Paper, released for comment by the Insolvency and Trustee Service Australia (ITSA) in May 2008.

As detailed in this submission, we support many of the amendments to the framework for trustee remuneration proposed by the paper. However, we are concerned that the tenor of the paper is primarily designed to ensure certainty for registered trustees rather than balance the interests of all involved – registered trustees, creditors and debtors. While registered trustees do deserve fair remuneration for their services, in practice, debtors' interests are often being sidelined in favour of trustees or creditors. We believe that amendments are required to both bankruptcy regulations and their enforcement, to ensure the weakest participants in the system – debtors and bankrupts – are not taken advantage of.

Where the trustee remuneration regime fails

The paper states that the regime governing the remuneration of registered trustees in bankruptcy should:

- maximise the value provided to recipients of insolvency administration services and the public in general;
- foster active price competition between personal insolvency practitioners; and
- fairly and efficiently resolve disputes about practitioner administration.

While we welcome the intent of these objectives, we believe that it is very difficult or even impossible for them to be achieved within the current bankruptcy laws and regulations.
It is our view that in the environment in which registered trustees operate, competition cannot function effectively to ensure that work is allocated to the practitioner who will provide the best service, at the lowest cost. This is because there is little economic incentive for a creditor to choose a trustee who charges lower fees than another trustee. Other than ensuring that the administration returns 100 cents in the dollar to creditors – as is quite possible with asset-rich consumer debt administrations – those creditors have no economic incentive to concern themselves with the quantum of the trustee’s fees.

This is exacerbated by the fact that registered trustees do not act on behalf of one identifiable client. Instead, trustees have a responsibility to administer an estate in the interests of both creditors and the bankrupt. We note that in many cases, only one creditor will appoint a trustee to pursue bankruptcy (and in some cases, other creditors may not even be aware that a trustee has been appointed). Given this, it is not clear how the appointment will be in the interests of all creditors, not to mention the interests of the bankrupt. While we note the intent of some of the proposals of the paper is to ensure the creditors take a more active role in setting trustee remuneration, we are not convinced that this can occur in practice.

The fact that a trustee has a role as ‘officer of the court’ and has a fiduciary relationship with both creditors and bankrupts gives rise to the potential for conflicts of interest. One such conflict of interest is between a bankrupt and the trustee, where the trustee is appointed to administer an estate in which the value of assets is much greater than the values of debts. In this circumstance, there is an incentive for an unethical trustee to incur fees inappropriately – knowing that the fees will be recoverable when assets are liquidated. Attached to this submission is a case study of a client of Consumer Action who was made bankrupt in relation to a debt of just under $12,000. Over a period of 12 months, the bankruptcy trustee incurred over $100,000 in fees. The bankrupt owned his own home and this is now under threat of sale from the bankruptcy trustee. It is our view that the action of the registered trustee amounted to equity-stripping and was clearly not in the interests of the debtor concerned. This is not an isolated incident, and we are aware of other bankrupts with similar experiences.

This case study demonstrates that the framework for the remuneration of trustees fails to maximise the value provided to recipients of insolvency administration services and the public in general. Indeed, the framework has resulted in the opposite – the value attributable to our client (his interest in his home) has been significantly diminished. Further, as outlined below, we do not believe the proposals relating to a review of remuneration trustees will necessarily retrieve that value. The final section of this submission suggests some reforms that we believe may assist in overcoming these problems – reforms that not only involve reform to the law, but also better enforcement by ITSA as the regulator of trustees.

**Proposed amendments to current framework**

*Minimum entitlement*

We strongly support the proposal that the minimum remuneration entitlement under section 161B of the *Bankruptcy Act 1966* (Cth) will no longer be recoverable as a debt from the bankrupt in the event there are insufficient funds in the estate. Consumer bankrupts, by their
nature, are experiencing financial hardship. Given that a primary public policy reason for the existence of bankruptcy is to give a debtor a fresh start by wiping most of their debts, we think that it makes no sense to enable a trustee’s claim for minimum entitlement shortfall to survive bankruptcy.

Remuneration prescribed by the regulations

We broadly support the removal of regulation 8.08 which provides for a default amount of remuneration for registered trustees. However, given the failure of competition outlined above, we do believe there is a case for further regulatory intervention in relation to the levels of trustee remuneration. As outlined below, we consider the reviews of remuneration to be undertaken by the Inspector-General (both prospective and retrospective) are appropriate regulatory interventions.

Remuneration fixed by creditors

We broadly support the proposals to allow creditors to initiate a resolution relating to trustee remuneration outside a creditors meeting and for the requirements of section 64U to apply whether the resolution is made with or without a meeting of creditors. We are not convinced, however, that these proposals will necessarily engage creditors to be more actively involved in the setting of trustee remuneration. We continue to be concerned about the nature of parties representing creditors in any decision-making about remuneration, and whether those parties are really acting in the interests of creditors. In our experience, many of the parties involved have ongoing relationships with trustees and the interests of creditors are not in fact promoted. This is due to the way in which most creditors, particularly large financial service providers, deal with debts once bankruptcy has occurred. In most cases, debts are written off as a matter of course, and even if there is a chance that a creditor could obtain some recourse from a bankrupt’s estate, the automated nature of financial service provider’s processes means that this is often not followed in practice. Rather, the creditor’s interests may be devolved to debt collectors or solicitors, many of which have professional relationships with trustees (and are influenced by the potential of the cross-referral of work, rather than price).

Review of remuneration by the Inspector-General

Review of remuneration where agreement of trustees not achievable

We support the proposal for a registered trustee to have the right to apply to the Inspector-General to determine whether proposed remuneration arrangements are reasonable. We note that this is designed to be last resort and that a trustee should seek agreement from creditors before remuneration arrangements are reviewed by the Inspector-General.

The paper says that in such a review, the Inspector-General would not review or consider the reasonableness of the (for example, hourly) rate of remuneration charged by the trustee. Rather, the review would consider, for example, whether the estimate of remuneration for the work appears to be commensurate with the tasks that have to be conducted and whether the work to be undertaken appears to be necessary and reasonable. We strongly support such a holistic approach, but believe that the framework should not prevent the Inspector-
General to consider the appropriateness of hourly rates proposed. This could be because, for example, the remuneration proposal puts forward partner rates for particular tasks that would more appropriately be undertaken by a more junior practitioner.

The paper states that a mechanism for reviewing or appealing against decisions of the Inspector-General is envisaged. We believe that such an appeal mechanism should be limited so that there is not an incentive for registered trustees to appeal decisions made in order to increase costs recovered. For example, costs associated with pursuing an appeal should not be recoverable from an estate.

Review of remuneration already claimed

We strongly support the proposed improvements to the taxation review and, in particular, that the costs of the review be funded by Government. Our experience with the current review of taxation process has been that given the significant risk that applicants will bear the costs of taxation, a bankrupt is effectively prevented from seeking a taxation. Any initiation of the review process could result in further fees charged by the trustee which would eat further into any equity in assets held by the bankrupt.

We suggest that the framework for the taxation reviews should consider best practice principles of external dispute resolution as well as the Australian Standard on Complaints Handling. The benchmarks are accessibility, independence, fairness, accountability, efficiency and effectiveness.1 While these benchmarks are more relevant for industry-based EDR schemes, we believe that a number of benchmarks should be applied to the framework for the taxation review. In particular, the benchmarks relating to accountability, accessibility and fairness are crucial. Fairness not only involves procedural fairness, but should ensure substantive fairness so that not only the process but the end result is considered to be fair. Importantly, the review should also explicitly consider good industry practice in making any finding. Good industry practice could be referable to the Insolvency Practitioner’s Code of Professional Practice, which makes it clear that a trustee is only entitled to claim remuneration in respect of necessary work, properly performed in an administration.

The consultation paper notes that the 28 day time limit for initiation of a taxation review detracts from the review’s usefulness. We agree, but think that the proposal for the Inspector-General to have power to grant an extension of time is not the best response to the problem. Requiring an applicant to seek an extension of time would just impose another barrier and will not necessarily improve accessibility in practice. Instead, we would suggest that the time limit should be extended to, say, one year, with a discretion for the Inspector-General to accept late applications.

The consultation paper also states that the current procedure for taxation review is inflexible and that it requires an item by item assessment of the bill of costs, rather than a holistic assessment of the work performed and the fees claimed. We agree, and note that a particular problem of the review process is that it only considers whether the remuneration for services performed is appropriate and not at whether the services were appropriate. We believe that the review must be more than a mere taxation review and must enable

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1 Benchmarks for Industry-Based Customer Dispute Resolution Schemes.
consideration of whether work undertaken was reasonably necessary, efficient and appropriate having regard to, inter alia, the size of the debt and the size of the bankrupt’s estate. While the consultation paper suggests that a holistic review is more appropriate, the proposal does not clearly state that the review should be an effective route for a bankrupt to challenge a trustee who over-services and performs lengthy and expensive work, which was not appropriate.

Further reforms required

In many respects, we consider the law relating to trustee remuneration to be appropriate and that the best response to any problems of any excessive trustee fees is not further law reform. Rather, we believe that more and better enforcement action would be preferable.

In fact, in our view, the law imposes some clear obligations on trustees in relation to remuneration. Section 19(1)(j) of the Bankruptcy Act states that a trustee must administer an estate as efficiently as possible by avoiding unnecessary expense and section 19(1)(k) provides that a trustee must exercise their powers and perform functions in a commercially sound way. Further, regulation 2.13(b) of Schedule 4A of the Bankruptcy Regulations requires a trustee to consider the value and complexity of an administration when deciding whether or not to incur a cost. It is our view, as such, that the proportion of trustee’s remuneration to total creditor’s claims is a relevant consideration in determining a trustee’s breach of duties.

Case law also suggests that trustees are required to administer the estate with a view of achieving the maximum return from the bankrupt’s assets to satisfy the claims of the creditors and to provide the best surplus possible for the bankrupt (eg, Adsett v Berlouis (1992) 37 FLR 201).

Given this, we think there is a strong case for the regulator to better enforce these obligations. Section 179 of the Bankruptcy Act gives the Inspector-General a broad power to inquire about registered trustees’ administration of estates or to initiate court proceedings seeking any order the court sees fit, including the removal of the trustee from office. We believe that the Inspector-General could more effectively use its powers under section 179 to take action against registered trustees that charge excessive fees with a view to strip equity from a bankrupt’s estate.

Even if the Inspector-General did not take action, the enforcement framework should include other sanctions for breach of a trustee’s duty. We would welcome consideration to be given to whether the enforcement framework for registered trustees can be improved in such a way, for example, through the application of penalties, fines and/or damages for breach of trustee’s duties.

In the event that it is viewed that the trustees’ duties outlined above do not provide sufficient basis for enforcement action against a trustee, we would welcome further consideration of amendment to the law to ensure that this broad principle of proportionality with the respect to the remuneration of registered trustees is reflected in statute. We believe that such a principle would be a useful addition in any event, in particular for when the Inspector-General undertakes a review of remuneration pursuant to the proposals of the consultation paper.
Other issues

While we acknowledge that this issue is not in the remit of the current consultation, we would welcome further consideration be given to the minimum debt on which a creditor’s petition for bankruptcy can be made (the current amount is $2,000, unchanged since 1996 despite a significant change in real value of the amount\(^2\)). Given the significant detriment that can occur to individuals who own property that are made bankrupt on a creditor’s petition for a small amount, we believe there is a strong case of increasing this minimum substantially. We support the recommendation of Jan Pentland’s *Homes at Risk* report, which recommends that the amount be increased to $10,000.

Should you have any questions in relation to this submission, please contact me on 03 9670 5088.

Yours sincerely

CONSUMER ACTION LAW CENTRE

Gerard Brody
Deputy Director – Policy & Campaigns

\(^2\) We note that the amount was increased from $500 to $1,000 in 1980 and from $1,000 to $1,500 in 1985.