# Articles

## Private enforcement of liquidator obligations[*]

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*The regulation of insolvency practitioner behaviour has received sustained attention in the last two years. However, little focus has been given to the potential for private enforcement of liquidator obligations to support the modernisation of regulation in this context. This paper discusses the bases that might ground an action against a practitioner and considers who may have standing to bring those actions. The way in which those actions might serve dual compensatory and regulatory functions is also addressed. While the efficacy of private enforcement is as yet untried, the necessary constituent elements seem to be present. If effective, private enforcement measures would contribute to regulatory pluralism in this area, in itself a desirable outcome. By incorporating private actions against delinquent insolvency practitioners into the broader regulatory framework, better regulation may be achieved.*

## I Introduction

Insolvency practitioner behaviour came under the spotlight in 2010 with a Senate Economics References Committee inquiry[1] concerning the conduct of the insolvency profession and the adequacy of efforts to monitor, regulate and discipline misconduct.[2] This inquiry had been commissioned by the Senate of the Australian Federal Parliament in response to complaints about the unfettered conduct of some insolvency practitioners,[3] as well as ASIC's perceived slowness in responding to public complaints.[4] The Senate

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1 The Senate Economics References Committee published the results of its inquiry in a report titled 'The Regulation, Registration and Remuneration of Insolvency Practitioners in Australia: The Case for a New Framework' September 2010, at <http://www.aph.gov.au/senate/committee/economics_ctte/liquidators_09/report/report.pdf>, (accessed 1 November 2010) at [1.4] (Senate Inquiry Report).

2 Senate Inquiry Report, ibid, at [1.4].

3 These complaints tended to crystallise upon the apparent 'gouging' behaviour of one insolvency practitioner, Mr Stuart Ariff — the case of Mr Stuart Ariff being described as the 'most notorious and well-publicised' in the Senate Inquiry Report, ibid, at [5.1].

4 This perception fuelled criticism in the media that the public regulator was inept when it

Economics References Committee in fact indicated that a central theme of the inquiry was 'the criticism of the role of ASIC as the principal regulator of the insolvency industry in Australia'[5] and a key recommendation of the committee was that the corporate insolvency arm of ASIC be transferred to the Insolvency and Trustee Services of Australia (ITSA) — the government agency responsible for the administration and regulation of the personal insolvency system in Australia. An options paper titled 'A Modernisation and Harmonisation of the Regulatory Framework Applying to Insolvency Practitioners in Australia' was subsequently released.[6] The options paper, in line with the recommendation made in the Senate Inquiry report, sought views 'in relation to options for the modernisation and alignment of the corporate and personal insolvency regulatory frameworks'.[7] The latest development in the insolvency law reform process is a proposals paper that was released by the Federal government in December 2011.[8]

A number of worthwhile recommendations and options are highlighted in the Senate Inquiry report, options paper and proposals paper.[9] However, it is interesting to note that while the Senate Inquiry Report, the options paper, as well as the proposals paper emphasise the role of a public regulator in regulating insolvency practitioner behaviour — very little, if any, attention is given to the role that private actions could play in a regulatory context.

Private actions against delinquent insolvency practitioners offer an opportunity for compensation for those who suffered harm. In addition, private actions can provide an effective deterrent to non-compliance, providing a public benefit. A premise of this article is that private enforcement of insolvency practitioner obligations could serve a valuable complementary regulatory function. This necessitates an analysis of the *bases* of private actions against liquidators, as well as the *eligibility* of plaintiffs to bring such actions (Part II). Private actions against liquidators are then considered in the context of a regulatory theoretical perspective (Part III).

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came to investigating insolvency practitioners. See, eg, A Ferguson, 'Ariff Shows ASIC's Ineptitude', *The Sydney Morning Herald* (Sydney), 24 August 2010, at <http://www.smh.com.au/business/ariff-shows-asics-ineptitude-20100823-13ipa.html> (accessed 25 August 2010).

5 Senate Inquiry Report, above n 1, at [6.6].

6 Australian Government, 'Options Paper: A Modernisation and Harmonisation of the Regulatory Framework Applying to Insolvency Practitioners in Australia', June 2011 (Options Paper).

7 Options Paper, ibid, p 1.

8 Australian Government, 'Proposals Paper: A Modernisation and Harmonisation of the Regulatory Framework Applying to Insolvency Practitioners in Australia', December 2011 (Proposals paper).

9 Eg, more proactive surveillance of insolvency practitioners by having a 'flying squad' conduct spot-checks on individual insolvency practitioners; a tightening of the insolvency practitioner registration procedure and professional indemnity insurance renewal scheme; compliance with a voluntary code of compliance regarding remuneration reportage; better statistical collection and public access to data concerning insolvency matters (see Senate Inquiry Report, above n 1, at [11.9]–[11.64]), as well as proposed extra funding of $11.4 million to the public regulator, ASIC, to 'police' the industry. See P Durkin, 'ASIC reins in rogue liquidators', *The Australian Financial Review*, 14 December 2011, for a synopsis of proposals.

# II Legal framework for private actions against delinquent insolvency practitioners

## A Potential bases of action

Insolvency practitioners have extensive powers to enable them to fulfil their responsibilities in regard to the voluntary administration or liquidation of a company.[10] These wide powers are counterbalanced by a range of duties aimed at protecting the interests of those that could be harmed by an abuse of power by the insolvency practitioner. A breach of these obligations could provide potential bases of action against a practitioner, enabling those who suffered harm as a result of the breach to claim redress. Insolvency practitioner obligations will be considered below in terms of statutory duties, equitable fiduciary duties, duty of care, contractual duty of care/agency, and misleading or deceptive conduct.

### 1 Statutory duties

Apart from statutory duties that apply to insolvency practitioners specifically in their capacity as administrators,[11] or liquidators,[12] these practitioners are included under the definition of 'officer of a corporation'[13] and, as such, will also be subject to general statutory duties that apply to officers. These include a duty of care and diligence,[14] a duty to act in good faith in the best interests of the corporation and for a proper purpose,[15] a duty to not improperly use their position to gain an advantage for themselves or someone else or cause detriment to the corporation,[16] and to not use information that they obtained as officers of the company to gain such benefit or cause such detriment.[17]

Since the provisions in terms of which these duties are imposed on directors and officers of corporations are civil penalty provisions, non-compliance with the statutory duties could result in the court making a declaration of contravention,[18] allowing an order to pay a pecuniary penalty of up to $200,000.[19] The court may also order the person to compensate the

10 Eg, powers described in the Corporations Act 2001 (Cth) ss 437A (in relation to administrators), 477 (in relation to liquidators in a compulsory winding up), and 506 (in relation to liquidators in a voluntary winding up).

11 Eg, the duty to investigate the affairs of the company and to consider possible courses of action (s 438A); the duty to lodge accounts in the prescribed form (s 438E); and the duty to report to creditors by way of the mandatory meeting of creditors (s 439A).

12 Eg, a duty to collect and apply the company's property in discharging the company's liabilities (ss 474(1) and 478(1)); a duty to investigate and to report (ss 475 and 476); a duty to keep proper records and accounts (ss 531 and 539); a duty to report on any possible breaches by a past or present officer or employee, member or contributory, or promoter of the company (s 533(1)); and a duty to maintain the books of the company kept prior to winding up (s 542).

13 Corporations Act 2001 (Cth) s 9.

14 Ibid, s 180(1).

15 Ibid, s 181(1).

16 Ibid, s 182(1).

17 Ibid, s 183(1).

18 Ibid, s 1317E.

19 Ibid, s 1317G(1). However, a court may not make pecuniary penalty order against a person

corporation for damage suffered by the corporation as a result of the contravention.[20]

The only body with standing to apply for a declaration of contravention or a pecuniary penalty order is ASIC.[21] An application for a compensation order, on the other hand, can be brought either by ASIC, or the corporation, and can be made independently from any declaration of contravention.[22]

### 2 Equitable fiduciary duties

In addition to a wide range of statutory obligations, liquidators are classified as fiduciaries and will consequently have to comply with typical fiduciary duties.[23] Fiduciary duties imposed on insolvency practitioners overlap to some extent with the statutory duties owed in their capacity as officers. However, these duties continue to play an important role in controlling liquidator conduct, because of their ability to complement the 'bare norms in ss 181–182'[24] and also because of their ability to provide a remedy in instances where wrongs occur despite compliance with statutory duties.[25]

The judicial formulation of liquidators' equitable fiduciary duties recognises that the imposition of such duties serves to protect the interests of the company's creditors, its members and of the public in general.[26] However, it does not provide any indication of how liquidators' fiduciary duties are capable of being enforced by any of these interest groups and this remains a significant issue in determining the extent to which creditors could engage in private enforcement actions.

### 3 Duty of care

The fact that liquidators, as paid professionals, owe a general law duty of care and skill has been recognised by the court,[27] although negligence actions

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for such a contravention if that person has been convicted of an offence on the basis of conduct that is substantially the same as the conduct on which the contravention is based (s 1317M).

20 Ibid, s 1317H.

21 Ibid, s 1317J(1).

22 Ibid, s 1317J(2).

23 This is apparent from the court's statement in *ASIC v Edge* (2007) 211 FLR 137; [2007] VSC 170; BC200703944 at [44] that:

> The extensive powers vested exclusively in the liquidator entail a corresponding vulnerability in the creditors, members and the public. The liquidator is a fiduciary on whom high standards of honesty, impartiality and probity are imposed both by the Act and the general law.

Even though the pronouncement by the court was made in respect of liquidators there seems to be no reason in principle why administrators, by the same token, would not be subject to similar fiduciary duties.

24 J Glover and J Duns, 'Insolvency Administrations at General Law: Fiduciary Obligations of Company Receivers, Voluntary Administrators and Liquidators' (2001) 9 *Insolvency LJ* 130 at 143.

25 Ibid.

26 (2007) 211 FLR 137; [2007] VSC 170; BC200703944 at [44].

27 See, eg, *Maelor Jones Investments (Noarlunga) Pty Ltd v Heywood-Smith; Van Reesema v Heywood-Smith* (1989) 54 SASR 285 at 288; (1989) 7 ACLC 1232, where the court refers to a passage from *Re Home and Colonial Insurance Co Ltd* [1930] 1 Ch 102 at 125, to illustrate that 'there can be no doubt that, in the circumstances of the case, a high standard of care and diligence is required from a liquidator . . . He is of course paid for his services'.

against liquidators have not been common to date.[28] A breach of this duty could result in liability analogous to that of directors in breach of their general law duty of care, skill and diligence.[29] This duty is seemingly capable of being enforced by creditors of, and contributories to, the company.[30]

### 4 Contractual duty of care/agency

Analogous to the position of a director of a corporation who may be simultaneously liable to a company in negligence, for breach of statutory and fiduciary duties, as well as for breach of contract, potential may exist for a liquidator to owe contractual obligations to a company. The extent to which the duty owed by a liquidator might be grounded in any contractual liability seems unclear. As between the company and the liquidator there is clearly a relationship of agency,[31] even though the liquidator differs in status from that of a standard agent because of their high level of control over the principal's (the company's) actions.[32] Were a separate head of contractual liability to exist, implications would arise potentially both in the computation of compensation for misfeasance and in relation to the relevant standard of conduct.

### 5 Misleading or deceptive conduct

In *Fraser v NRMA Holdings*[33] the Full Federal Court identified the overlap between directors' general law fiduciary duty of disclosure and the operation of the then s 52 of the Trade Practices Act 1974 (Cth)[34] and indicated that a failure to properly discharge the fiduciary duty may constitute a contravention of s 52.[35] Liquidators are subject to similar fiduciary- type duties and

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The court furthermore indicates that the duty of care owed by liquidators does not involve any principles that could be typified as 'profoundly novel', but merely involves an application of 'well-settled legal concepts of the law of negligence' (at Ch 290). The contrary argument was raised in *Sydlow Pty Ltd v TG Kotselas Pty Ltd* (1996) 65 FCR 234; 144 ALR 159; 20 ACSR 47; BC9601203, but rejected by Tamberlin J at FCR 244; ALR 167 and the court ultimately confirmed that '[t]he liquidator's duty to exercise reasonable care and skill is similar in substance from the duty of care owed by other professional persons providing services for reward' (at FCR 241; ALR 169).

28 CCH, *Company, Corporate & Securities Law: Australian Corporations Commentary*, at 21 January 2011, para 161-580.

29 *Sydlow Pty Ltd v TG Kotselas Pty Ltd* (1996) 65 FCR 234 at 243; 144 ALR 159 at 168; 20 ACSR 47; BC9601203.

30 As indicated by a successful action for damages brought against a liquidator by these two interest groups in *Maelor Jones Investments (Noarlunga) Pty Ltd v Heywood-Smith; Van Reesema v Heywood-Smith* (1989) 54 SASR 285; (1989) 7 ACLC 1232. Despite Tamberlin J's recognition of this duty in *Sydlow Pty Ltd v TG Kotselas Pty Ltd* (1996) 65 FCR 234; 144 ALR 159; 20 ACSR 47; BC9601203 the question of to whom, other than the company, any such duty will be owed was not canvassed.

31 A R Keay, *McPherson's Law of Company Liquidations*, Sweet & Maxwell, 2001, p 371.

32 Ibid, p 369.

33 (1995) 55 FCR 452 at 466; 127 ALR 543; 15 ACSR 590 at 601; (1995) ATPR 41-374.

34 Following recent significant changes to the Trade Practices Act 1974 (Cth), there has been a renumbering and renaming of the provision formally known as s 52 of the Trade Practices Act, which now forms part of Pt 2-1: Misleading and Deceptive Conduct, *Australian Consumer Law*, Sch 2 to the Competition and Consumer Act 2010 (Cth); s 18 replaces s 52 of the Trade Practices Act 1974 (Cth). These changes became law on 1 January 2011 when the Trade Practices Act 1974 (Cth) became the Competition and Consumer Act 2010 (Cth).

35 Trade Practices Act 1974 (Cth). Section 52 provided:

non-compliance with these duties could expose them to liability on the basis of a contravention of the equivalent duty under the Competition and Consumer Act 2010 (Cth).

## B Enforcement of insolvency practitioner obligations

The above discussion clearly indicates that insolvency practitioners are subject to extensive statutory and general law duties. Commonsense dictates that these duties serve to protect the interests of those who are vulnerable to harm where there is a breach of these duties, namely, creditors of a company and, in cases where the company is not insolvent, also the members of that company. However, the way in which these duties are formulated by no means makes it clear whether, or how, these groups will be able to bring an action in all cases involving a breach of duties by the insolvency practitioner. A duty owed by a liquidator without an accompanying remedy would offer hollow protection indeed and it is clearly important to establish whether current principles of law allow those who were prejudiced by insolvency practitioner misconduct to bring an action.

In order to determine whether enforcement remedies are available to creditors, the discussion below will analyse the enforcement of insolvency practitioner obligations with reference to the supervisory role of the court and ASIC, the potential to bring actions in the name of the company, and lastly the ability of creditors to proceed directly with actions against the delinquent insolvency practitioner.

### 1 Supervisory role of the court and ASIC

Section 536 of the Corporations Act 2001 (Cth) provides that a liquidator is subject to supervision by the court and/or ASIC in the performance of his or her duties. The court describes the purpose of this provision as to ensure the 'lawful, orderly and efficient conduct of the affairs of corporations' during a period where 'normal market forces and the exercise by shareholders of their rights to control are attenuated or non-existent'.[36] In cases such as *Commissioner for Corporate Affairs v Harvey*[37] the court expressly indicated that, where it is satisfied that the liquidator has been guilty of misfeasance, neglect or omission, as a consequence of which there has been financial loss to the company, this provision empowers it to order the liquidator to make

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(1) A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

(2) Nothing in the succeeding provisions of this Division shall be taken as limiting by implication the generality of subsection (1).

The close relationship between directors' fiduciary duty of disclosure and this provision is also recognised in *ENT Pty Ltd v Sunraysia Television Ltd* (2007) 61 ACSR 626; (2007) 25 ACLC 399; [2007] NSWSC 270; BC200701989 at 628.

36 *Hall v Poolman* (2009) 254 ALR 333; 71 ACSR 139; [2009] NSWCA 64; BC200902007 at [53].

37 [1980] VR 669; (1979) 4 ACLR 259; (1979) CLC 40-564. Marks J provides a detailed analysis of s 278 of the Companies Act 1961 — the equivalent provision in force at that time — in this case (VR 682–9), which analysis has been described as '[t]he most influential modern analysis' of this provision in *ASIC v Edge* (2007) 211 FLR 137; [2007] VSC 170; BC200703944 at [70].

good the loss and to make any other order which it thinks fit.[38] This interpretation has been endorsed subsequently in *ASIC v Edge*.[39]

The interpretation and application of s 536 in this way could create the impression that it provides those wronged by misconduct on the part of a liquidator with an effective remedy to recover the loss that they suffered as a result. However, a number of fairly recent cases indicate that the court views the purpose of s 536 as being to protect the *public interest*, rather than to serve as a tool for enforcement of *private actions*.[40] This point is made particularly clear in *BL & GY International Co Ltd v Hypec Electronics Pty Ltd* where the court, despite recognising that an inquiry under s 536 may lead to an order that the liquidator make good a loss sustained by the company, expressly warns against attempting to use s 536 for something that 'is really an action for negligence or other breach of duty by a liquidator'.[41] The court furthermore describes the emphasis of s 536 to be on 'regulation, supervision, discipline and correction of liquidators in the interests of honest and efficient administration of the estates of companies subject to winding up', that it is to serve a 'public interest', and that it is not concerned 'in any direct way with vindication of private rights'.[42] This does not preclude a company in liquidation with a cause of action against a liquidator from suing the liquidator accordingly, but such a course of conduct would be regarded as 'something quite separate from a s 536(1) inquiry'.[43]

This analysis and application of s 536 places a question mark over its appropriateness as a means to enable creditors to recover compensation from liquidators in breach of their obligations.[44] In some instances creditors also seem to question ASIC's willingness or ability to exercise the power that it has under this provision,[45] which raises some doubts as to its effectiveness,

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38 *Commissioner for Corporate Affairs v Harvey* [1980] VR 669 at 689; (1979) 4 ACLR 259; (1979) CLC 40-564.

39 (2007) 211 FLR 137; [2007] VSC 170; BC200703944 at [88].

40 See, eg, *Hall v Poolman* (2009) 254 ALR 333; 71 ACSR 139; [2009] NSWCA 64; BC200902007 at [66]–[67] in which case the Full Court of the Court of Appeal emphasises the regulatory nature of the powers conferred in terms of this provision. It furthermore indicates support for the approach adopted in *Northbourne Developments Pty Ltd v Reiby Chambers Pty Ltd* (1989) 19 NSWLR 434 at 438; 1 ACSR 79; (1989) 8 ACLC 39 at 43, in terms of which the court's supervisory role under a s 536 type provision is described as being concerned with 'aspects of the conduct of liquidators which are liable to attract sanctions or control for what might broadly be described as disciplinary reasons'.

41 (2010) 79 ACSR 558; [2010] NSWSC 959; BC201006295 at [34]–[35].

42 Ibid, at [41]. This view is also endorsed in *Kennards Hire Pty Ltd v RMGA Pty Ltd* [2010] NSWSC 1387; BC201009034 at [37].

43 *BL & GY International Co Ltd v Hypec Electronics Pty Ltd* (2010) 79 ACSR 558; [2010] NSWSC 959; BC201006295 at [82].

44 The ability of 'any person' to make a complaint to the court or to ASIC under s 536(1) may nonetheless be of strategic value in any action against a liquidator for misconduct. Authority suggests 'any person' literally means just that and it is not necessary for a complainant to establish a particular connection with the liquidation. See *Nortbourne Developments Pty Ltd v Reiby Chambers Pty Ltd* (1989) 19 NSWLR 434 at 439; 1 ACSR 79; (1989) 8 ACLC 39 at 43.

45 According to the Senate Inquiry Report, above n 1, p 68 numerous submissions noted that complaints to ASIC about the conduct of insolvency practitioners were either not answered, answered much later, or filed without any subsequent action and it describes the 'unresponsiveness' of the regulator as a significant theme of the inquiry.

specifically in relation to ensuring compensation for creditors that were prejudiced by liquidator misconduct, and more generally in relation to regulating liquidator conduct.

## 2 The company as plaintiff

Creditors could attempt to enforce liquidators' duties more directly through the entity of the company. This approach would recognise the company as the primary beneficiary of liquidators' duties and as the proper plaintiff in case of a breach of duties by a liquidator. The enforcement of liquidators' duties in this way would be analogous to the way in which duties of directors are traditionally enforced[46] and would seem to be most suited in cases where liquidators are in breach of duties owed to the company, for example statutory duties that they owe in their capacity as officers of the company, or equitable fiduciary duties owed to the company.

An advantage of such an approach is that any benefit from a successful action would flow to the company.[47] This means that any benefit could be shared according to rules of distribution that would normally apply.[48] Any such distribution will consequently not violate principles of insolvency law, including the pari passu principle. A practical problem inherent in this approach is that the liquidator, who is allegedly in breach of his or her duties, has control over the company.[49] Such a liquidator would for obvious reasons not be interested in pursuing an action on the company's behalf. The same holds true where directors who are in control of the company are in breach of their duties to the company. However, in such cases members of a company are statutorily provided with a derivative action which entitles them to bring proceedings on behalf of the company and which would aid them in taking action on behalf of the company against directors in breach of their duties.[50] In some instances members of the company may also make use of the oppression remedy in terms of s 232 of the Corporations Act 2001 (Cth) to seek redress against delinquent directors, under circumstances where the

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46 Traditional company law dogma describes directors' duties as being owed to the company. See, eg, *In re Smith & Fawcett* [1942] Ch 304 at 306; [1942] 1 All ER 542 where the court clearly stated that directors should act '*bona fide* in what they consider . . . is in the interest of *the company*' (emphasis added). As such the company is the proper plaintiff in case of a breach of directors' duties. This formulation is echoed in statute in terms of s 181(1) of the Corporations Act 2001 (Cth).

47 It has to be noted that the proceeds of a successful action brought on behalf of the company would potentially bring the funds under control of the delinquent liquidator again. The court could, however, on cause shown, remove that liquidator and appoint another, in terms of the Corporations Act 2001 (Cth) s 473(1) (in case of winding up by court) and s 503 (in case of voluntary winding up).

48 See Pt 5.6 Div 6 subdiv D of the Corporations Act 2001 (Cth).

49 In terms of s 471A(1) of the Corporations Act 2001 (Cth) in case of a winding up by court order and s 499(4) in case of a voluntary winding up. The liquidator is furthermore expressly endowed with the power to 'bring or defend any legal proceeding in the name and on behalf of the company' (s 477(2)(a)).

50 The statutory derivative action is provided for in terms of Pt 2F.1A of the Corporations Act 2001 (Cth).

conduct of the directors is seen as contrary to the interests of the members as a whole.[51]

The analysis below contemplates the question of whether creditors have access to similar mechanisms to assist them in prosecuting an action against a liquidator on behalf of the company. Of those mechanisms commonly available to bring action on behalf of a company, some offer more potential to aggrieved creditors than others.

### *(a) Residual powers of directors*

Directors are able to exercise their powers in certain situations, even after the appointment of a liquidator: in the case of a winding up by court order, court approval would be required to enable directors to bring an action,[52] while in the case of a voluntary winding up only creditor approval is required.[53] It would be possible, therefore, for creditors to informally request directors to obtain the necessary approval so that they can bring an action on behalf of the company in cases of a winding up by court order, or to provide such approval themselves in cases of voluntary winding up.

### *(b) Derivative action*

It is doubtful that creditors would be able to use the statutory derivative action to initiate proceedings against a liquidator in breach of his or her duties. First, because the right to bring proceedings on behalf of a company by way of a statutory derivative action is conferred exclusively on 'a member, former member, or person entitled to be registered as a member, of the company or of a related body corporate'[54] or on 'an officer or former officer of the company'.[55] Second, creditors' ability to make use of the derivative action to enforce liquidators' obligations is also impeded by the fact that the court indicated that this suit is not available in respect of companies in liquidation.[56]

One possible solution to the above problem would be to amend the Corporations Act 2001 (Cth) so as to add creditors to the list of those who could bring proceedings on behalf of the company. In light of the fact that the courts pronounced that the derivative action is not available in respect of companies in liquidation, as indicated before, any amendment to the legislation would further need to expressly extend the application of the derivative action to such companies, for creditors to be able to use this suit to proceed against liquidators in breach of their duties.

### *(c) Inherent jurisdiction of the court*

A further alternative, which carries the benefit of not requiring legislative amendment, is the approach suggested by the Full Court of the South

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51 See, eg, cases such as *Re Spargos Mining NL* (1990) 3 WAR 166; 3 ACSR 1; (1990) 8 ACLC 1218; BC9003840; *Jenkins v Enterprise Gold Mines NL* (1992) 6 ACSR 539; 10 ACLC 136.

52 Corporations Act 2001 (Cth) s 471A(1A)(d).

53 Ibid, s 499(4).

54 Ibid, s 236(1)(a)(i).

55 Ibid, s 236(1)(a)(ii).

56 *Chahwan v Euphoric Pty Ltd* (2008) 245 ALR 780; 65 ACSR 661; [2008] NSWCA 52; BC200802354 at [124]. This decision was subsequently followed in *Pearl Coast Divers Pty Ltd (in liq) v Cossack Pearls Pty Ltd* (2008) 249 ALR 591; [2008] FCA 927; BC200804973.

Australian Supreme Court in *Ragless v IPA Holdings Pty Ltd*.[57] In this case the court afforded a contributory of a company in liquidation leave to prosecute an action in the name of the company, based on its inherent jurisdiction to authorise a creditor or contributor to sue in the name of the company.[58] The court justified this construction on the basis of s 477(6) and s 511(1) of the Corporations Act 2001 (Cth) which, according to the court's reasoning, would not have been affected by the enactment of s 236 and s 237.[59]

It has to be acknowledged that the party who obtained leave to prosecute the action in the name of the company in cases such as *Ragless v IPA Holdings Pty Ltd*[60] was a contributory and not a creditor and that none of the cases referred to under this part of the discussion pertain to an action against a liquidator on the basis of breach of liquidator obligations. However, there is no apparent reason why the court should not be willing to exercise its inherent jurisdiction in a similar fashion to permit creditors to bring an action in the name of a company in liquidation against a liquidator in breach of his or her duties.

## 3 Creditors as plaintiffs

As indicated above, it might be possible for creditors to proceed directly against an insolvency practitioner in breach of his or her duties. Given some of the uncertainties that exist in relation to actions by creditors on behalf of the company (as discussed above), direct action might be a more productive cause for aggrieved creditors.

### *(a) Section 1324*

Section 1324(1) provides the court with the ability to grant an injunction in cases where a person engages in conduct that constitutes a contravention of the Corporations Act 2001 (Cth); an attempt to contravene the Act; aiding a person or inducing a person or being knowingly a party to the contravention by a person of this Act;[61] or conspiring with others to contravene the Act.[62] An application for such an injunction can be brought either by ASIC, or a person whose interests are affected by the conduct.[63] Subsection (10) furthermore provides that the court, where it has the power to grant an injunction under this provision, also has the power to order the person contravening the Corporations Act to pay damages to any person.

There are different interpretations in respect of the availability of the remedy under subs (10). In some cases the court regards its ability to order

57 (2008) 254 LSJS 225; 65 ACSR 700; [2008] SASC 90; BC200802409.

58 Ibid, at [44].

59 The court relied on following passage from *Cape Breton Co v Fenn* (1881) 17 Ch D 198 at 207–8, referred to in *Ragless v IPA Holdings Pty Ltd* (2008) 254 LSJS 225; 65 ACSR 700; [2008] SASC 90; BC200802409 at [44] in support of this approach:

> The only parties to the proceedings in a winding-up are the liquidators, the contributories, and the creditors . . . Then on what principle is it that a creditor or contributory has been allowed to sue in the name of the company? On the same principle on which a man could always have filed a bill in the old Court of Chancery against his trustee to be allowed to use his name to recover the trust property. That is the principle.

60 (2008) 254 LSJS 225; 65 ACSR 700; [2008] SASC 90; BC200802409.

61 Corporations Act 2001 (Cth) s 1324(1)(c)–(e).

62 Ibid, s 1324(1)(f).

63 Ibid, s 1324(1).

damages as dependent on the applicant having sought an injunction.[64] In other cases the court does not feel itself so constricted and indicates a willingness to consider an application under this type of provision even if the only relief being sought is damages, without an application for an injunction.[65]

The court employed a broad interpretation of the phrase 'person whose interests . . . are . . . affected' in a number of cases to allow this remedy to be used to its fullest.[66] This has led commentators to describe s 1324 as a valuable remedy for minority shareholders.[67] However, it is not only minority shareholders who are able to make use of the remedy under s 1324 and in some instances the court went one step further and recognised the potential of this provision to protect the interests of a creditor.[68]

On the basis of the above discussion it seems, at first glance, as if s 1324 could be a handy tool in the hands of a creditor or creditors who intend to hold a liquidator liable for damages on the basis of a breach of statutory duties. The application of s 1324 for this purpose is not without problems of its own, however.

First, it should be noted that a broad construction of s 1324 has not been adopted in all cases.[69] Second, the ability of s 1324 to provide creditors with a tool to hold the liquidator liable for the loss that they suffered as a result of a breach of liquidator obligations is limited in that it only applies in cases of a contravention of the Corporations Act. It would, in other words, not provide

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64 *Artistic Builders Pty Ltd v Elliot & Tuthill (Mortgages) Pty Ltd* (2002) 10 BPR 19,565; [2002] NSWSC 16; BC200200187 at [132]; *Executor Trustee Australia v Deloitte Haskins Sells* (1996) 135 FLR 314; 22 ACSR 270 at 273; (1996) 14 ACLC 1789; BC9605323; *Waterhouse v Waterhouse* (1999) 46 NSWLR 449 at 490–1; (1998) 148 FLR 312; BC9802602.

65 *Gracia Pty Ltd v QCAPT Pty Ltd* (1998) 16 ACLC 1134; BC9801237 at 12; *Permanent Trustee Australia Ltd v Perpetual Trustee Co Ltd* (1994) 15 ACSR 722; (1994) 13 ACLC 66 at 70; BC9403432.

66 See, eg, *Airpeak Pty Ltd v Jetstream Aircraft Ltd* (1997) 73 FCR 161 at 167; 144 ALR 448; 23 ACSR 715 at 721; BC9701741; *Allen v Atalay* (1993) 11 ACSR 753 at 757; (1993) 12 ACLC 7; *Broken Hill Proprietary Co Ltd v Bell Resources Ltd* (1984) 8 ACLR 609 at 613–14; (1984) 2 ACLC 157; *Gracia Pty Ltd v QCAPT Pty Ltd* (1998) 16 ACLC 1134; BC9801237 at 12; and *QIW Retailers Ltd v Davids Holdings Pty Ltd (No 2)* (1992) 37 FCR 57 at 60; 109 ALR 377; 8 ACSR 333 at 336; BC9203609.

67 R Baxt, 'Corporate Gadflies — The Standing of Shareholders and Others to Bring a Case' (1994) 68 *ALJ* 758 at 758.

68 See, eg, *Allen v Atalay* (1994) 11 ACSR 753 at 757–8; (1993) 12 ACLC 7, in which case, the court stated that it is arguable that:

> a creditor having a right to prove in the liquidation of the company may be a person whose interests are affected by a contravention which is alleged to have led to the diminution in value of his claim against the company. Also see *Airpeak Pty Ltd v Jetstream Aircraft Ltd* (1997) 73 FCR 161; 144 ALR 448; 23 ACSR 715 at 721; BC9701741.

69 In *Mesenberg Cord Industrial Recruiters Pty Ltd* (1996) 39 NSWLR 128 at 137; 130 FLR 180; 19 ACSR 483 at 490–1; BC9600727, for example, the court indicated that an application for an injunction under s 1324 to prevent a breach of officers' statutory duties cannot be brought by somebody other than ASIC, as the civil penalty regime represents an exclusive code, including the consequences of a breach of the civil penalty provisions. The extent to which this provision could be used to recover damages from officers in breach of their statutory obligations is also uncertain. See R Baxt, 'Securing the Rights of Minority Shareholders: The courts Can Do It without the Need for Statutory Change' (1997) 25 *ABLR* 286 at 287.

creditors with a mechanism to claim damages from the liquidator in case of a breach of equitable fiduciary duties, or the general law duty of care. Third, it is unclear whether the provision under s 1324(10) gives rise to a corporate claim, or a personal claim.[70] Finally, the ability of individual creditors to bring an application under s 1324(10) could lead to multiplicity of actions, which would clearly not be a desirable outcome.

### (b) Remedy afforded to aggrieved persons

An alternative remedy might be found in s 1321 of the Corporations Act 2001 (Cth) which provides redress for a creditor aggrieved by 'any act, omission or decision' of a liquidator[71] and entitles any such creditor to appeal to the court. This provision endows the court with the power to 'confirm, reverse or modify the act or decision, or remedy the omission, as the case may be and make such orders and give such directions as it thinks fit'.[72] However, in *Re Glowbind Pty Ltd (in liq); Takchi v Parbery* the court suggests that the jurisdiction conferred by s 1321 is generally to be exercised under circumstances which concern the reversal or modification of a liquidator's decision.[73] This pronouncement renders it doubtful as to whether this provision affords the most appropriate mechanism to enable creditors to proceed against delinquent liquidators with a view to recover losses suffered by them as a result of a breach of liquidator obligations.

### (c) Creditors as a class

Where creditors do form a plaintiff group, their ability to successfully prosecute an action has been enhanced significantly by recent expansion of class action activity in the corporate context in Australia.[74] Significant procedural barriers (such as costs and information asymmetries) could, in many cases, militate against actions being brought by aggrieved creditors. However, class actions offer an opportunity to group proceedings, and thus overcome some of the procedural barriers. Conceptually, the discussion so far has proceeded on the basis that creditors of a particular company suffered harm as a result of wrongdoing on the part of the insolvency practitioner who had been appointed to administer the affairs of the company under a voluntary administration or liquidation. However, as was indicated in the case of Mr Stuart Ariff, it is possible that an insolvency practitioner may cause harm to

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70 P F Hanrahan, 'Distinguishing Corporate and Personal Claims in Australian Company Litigation' (1997) 15 *C&SLJ* 21 at 39.

71 It should be noted that the remedy in s 1321 is available to any aggrieved person and not only to creditors. This provision also applies in respect of those administering a compromise, arrangement or scheme (para (a)); a receiver, or receiver and manager (para (b)); an administrator (para (c)); and administrator of a deed of company arrangement executed by the company (para (ca)) and not only in respect of liquidators.

72 Corporations Act 2001 (Cth) s 1321.

73 (2003) 181 FLR 108; 48 ACSR 456 at 465; [2003] NSWSC 1190; BC200307894.

74 See S H Lim, 'Do Litigation Funders Add Value to Corporate Governance in Australia?' (2011) 29 *C&SLJ* 135 at 136; and V Morabito, 'An Empirical Study of Australia's Class Action Regimes — First Report: Class Action Facts and Figures', Department of Business Law and Taxation, Monash University, December 2009, p 3 (no para numbers available), at <http://www.buseco.monash.edu.au/blt/staff/december-report. pdf>, for further detail in this regard.

the creditors of a number of companies in which he or she is involved.[75] It may be at this point that class actions become relevant. The combined claims of creditors of a particular company may be too small to justify the expense of bringing of an action against the liquidator. However, the total amount of the aggregated creditor claims against the liquidator may be significantly higher and could make an action against the liquidator viable.

Part IVA of the Federal Court of Australia Act 1976 (Cth) provides for a federal class action procedure, thereby empowering the Federal Court has jurisdiction to hear class actions.[76] The threshold requirements for bringing a class action are first, claims should be brought by at least seven people; second, claims should arise out of 'the same, similar, or related circumstances'; and last, claims should give rise to a 'substantial common issue of law or fact'.[77] It has been noted that these preliminary tests have been interpreted liberally by the courts, which should make them relatively easy to satisfy in practice.[78]

It has to be noted that a class action by creditors would be available only insofar as the basis of the action is available to 'creditors'; in other words, one based on a breach of liquidator duties owed to creditors.[79] Should an action be based on a breach of liquidator's duties to the company, any action against the liquidator would have to be brought in the name of the company. In such a case it would be possible for a number of companies to aggregate claims against the liquidator through a class action, provided that the preliminary threshold of at least seven claims was first met.

## III Regulatory theoretical perspective

The discussion above indicates that there is a range of potential actions for private enforcement of liquidator obligations. This article asserts that such private actions can also have a regulatory function.[80] Regulatory theory offers

75 ASIC conducted an investigation into the work of Stuart Ariff Insolvency Administrators in respect of 16 separate insolvencies.

76 State legislation which provides for class actions exists in Victoria in terms of Pt 4A of the Supreme Court Act 1986 (Vic), as a result of which the Victoria Supreme Court also has jurisdiction to hear class actions. Legislation in Victoria mirrors federal legislation. A more expansive class action regime has been provided for in New South Wales in March 2011. See the new Pt 10 of the Civil Procedure Act 2005 (NSW). A detailed overview of the legislative framework is not provided here. See V Brand, S Lombard and J Fitzpatrick, 'Class Actions in an Insolvency Practitioner Context' (2011) 19 *Insolvency LJ* 222 at 224–6 for an overview of the framework.

77 Federal Court of Australia Act 1976 (Cth) s 33C(2).

78 S Clark and C Harris, 'Class Actions in Australia: (Still) a Work in Progress' (2008) 31 *Aust Bar Rev* 63 at 71.

79 A breach of duty that would be actionable by creditors would, eg, include a breach of the common law duty of care, as discussed above.

80 It is not the purpose of this paper to consider the well-developed debate concerning regulation by litigation in any detail. For further information in this regard, see, eg, W Kip Viscusi (Ed), *Regulation through Litigation*, Washington DC, Brookings Institution, 2001, p 1, who identifies a number of issues in the context of regulation by litigation, including the lack of judicial consideration of issues resolved through negotiated settlement; the potential absence of public interest considerations in such settlements; and policy issues around disproportionate legal fees. Also see B Yandle, A Dorchak and A P Morriss, 'Regulation by Litigation' (2011) 5 *Regulation and Governance* 241–9.

a useful lens for looking at the place of public and private enforcement measures in relation to insolvency practitioners. In this context a 'compliance pyramid' developed by Ayres and Braithwaite offers a widely-accepted public regulatory model.[81] In developing their regulatory model, Ayres and Braithwaite suggested a responsive approach or model to regulation.[82] This framework is expressed in the form of a well-known 'compliance pyramid',[83] which illustrates the core concept, namely, that the choice of remedy to ensure compliance with regulations becomes increasingly severe higher up the pyramid. It is argued that regulation is most effective when the ever-increasing intrusiveness is matched by ever-decreasing frequency of use.[84] The model thus creates an incentive to move towards more compliant behaviour.[85] The diagram below indicates the way in which the Ayres and Braithwaite compliance pyramid is typically illustrated.

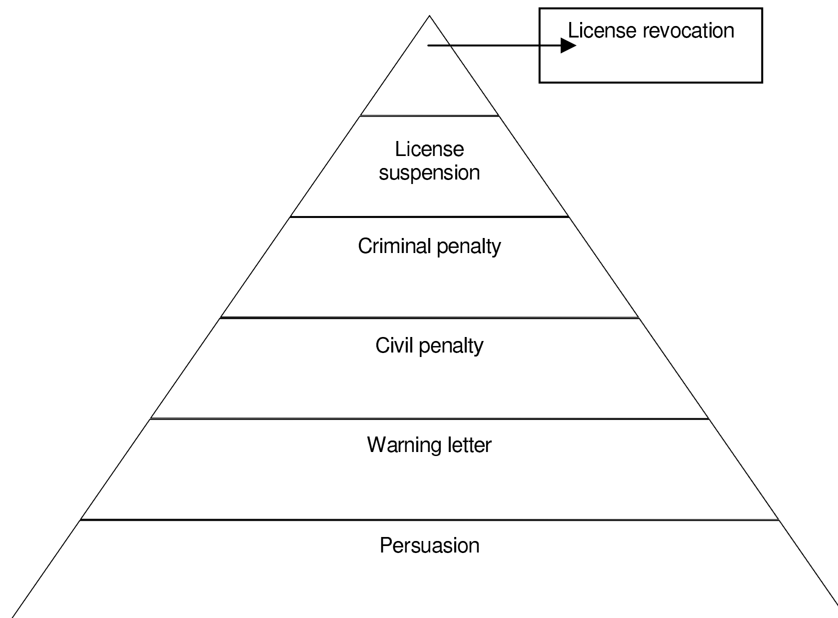
81 The regulatory pyramid elaborated by I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press, New York, 1992 enjoys wide recognition in the Australian public regulatory context and has been adopted by various regulatory agencies, eg, the Australian Taxation Office (ATO) and the Australian Competition and Consumer Commission (ACCC). For further detail on the ATO adoption of the pyramid, see K Murphy, 'Moving towards a More Effective Model of Regulatory Enforcement in the Australian Taxation Office', Working Paper No 45, November 2004, at <http://ctsi.anu.edu.au/publications/WP/45.pdf> **[Q: date accessed?]**. For further detail on the ACCC adoption of the compliance pyramid see C Parker, J Braithwaite and N Stepanenko, 'ACCC Enforcement and Compliance Project: Working Paper on ACCC Compliance Education & Liaison Strategies' April 2004, at <http://cccp.anu.edu.au/projects/compliancereportapril2004.pdf> (accessed 3 November 2011); as well as the ACCC Compliance and Enforcement Policy, at <http://www.accc.gov.au/content/item.phtml?itemId=867964&nodeId=af1ba8a3f3ce67c28f3aebafd4fb7e55&fn=Compliance%20and%20enforcement%20Policy.pdf> (accessed 3 November 2011). It was also adopted by the Cooney Committee in its recommendations regarding sanctions to regulate directors and officer conduct. See Senate Standing Committee on Legal and Constitutional Affairs, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*, 1989, pp 190–1.

82 Ayres and Braithwaite, above n 81, succeeded in converging two opposing schools of thought on regulatory theory, those adhering to the 'deterrence model' and those adhering to the 'accommodative model' of regulation, in their 'responsive model' of regulation. A deterrence model is traditionally premised on the idea that harsh sanctions and penalties should be used to ensure compliance, while the accommodative model depends on cooperation and persuasion. The responsive approach or model recognises and combines the relative merits of both, in identifying that the issue in ensuring effective compliance is not whether to punish or to persuade, but *when* to punish and *when* to persuade.

83 The Ayres and Braithwaite model has been described as the 'most influential theory of the optimal mix of regulatory strategies' in an Organisation for Economic Co-operation and Development (OECD) study on regulatory compliance. See OECD 'Reducing the Risk of Policy Failure: Challenges for Regulatory Compliance', 2000, p 74.

84 Ayres and Braithwaite, above n 81, pp 35–6. They assert that '[c]ompliance is optimised by regulation that is contingently co-operative, tough and forgiving' (p 51).

85 According to the authors of this model, its success lies therein that it allows regulators to 'speak softly, while carrying big sticks': Ayres and Braithwaite, above n 81, p 40.




## A Insolvency practitioner context

The Ayres and Braithwaite pyramid offers interesting insights into the regulation of insolvency practitioners.[86] It is not difficult to recognise existing public regulatory measures in its structure. The bottom layer of the pyramid, which largely relates to voluntary compliance with regulation, could be seen to be represented by codes of conduct and similar measures.[87] The power of the Companies Auditors and Liquidators Disciplinary Board (CALDB) under s 1292(9) of the Corporations Act 2001 (Cth) to admonish or reprimand a registered liquidator, or to require the liquidator to give an undertaking to engage in, or to refrain from engaging in particular conduct, could be equivalent to Ayres and Braithwaite's 'warning letter' in the second layer of the pyramid. Further, the civil penalty regime, in particular the pecuniary penalty that could be levied in cases of a breach of statutory duties by registered liquidators,[88] could be seen as reflecting the third layer of the

86 Precedent exists for extrapolating Ayres and Braithwaite's compliance pyramid into the corporate sphere. Various commentators noted the way in which the statutory regime for enforcement of directors' duties is mapped on the compliance pyramid. See, eg, G Gilligan, H Bird and I Ramsay, 'Civil Penalties and Enforcement of Directors' Duties' (1999) 22 *UNSWLJ* 417 at 425; M Welsh, 'Civil Penalties and Responsive Regulation: The Gap between Theory and Practice' (2009) 33 *MULR* 909 at 916.

87 See D Brown and C Symes, 'Insolvency Practitioner Regulation: Providing Practice Standards through the Use of Codes of Conduct', Bankruptcy and Insolvency Law Scholarship Unit (BILS) Adelaide Law School, University of Adelaide, at <http://www.law.adelaide.edu.au/research/bils/docs/Brown-Symes_-_Insolvency-practitioner-regulation.pdf> (accessed 20 December 2011), for more detail on application of codes of conduct.

88 Corporations Act 2001 (Cth) ss 1317E, 1317G, 1317J(1).

pyramid. A breach of statutory duties may also lead to criminal proceedings being taken against the registered liquidator.[89] This might represent the fourth layer of the pyramid. Finally, the power of the Companies Auditors and Liquidators Disciplinary Board under s 1292(2) of the Corporations Act 2001 (Cth) to suspend or cancel the registration of a liquidator, could lastly be regarded as corresponding to the top two layers of the pyramid.

## B Regulatory pluralism

The obvious value of the Ayres and Braithwaite model in providing a scheme for regulatory compliance cannot be denied. However, this compliance pyramid has traditionally been applied in the context of public regulation. Nonetheless, private enforcement mechanisms may contribute to an effective regulatory framework. This concept is referred to as 'regulatory pluralism' and has led researchers to recognise the importance of other aspects, such as the role of third parties as 'enforcers' of policy objectives, in achieving regulatory compliance.[90] It is interesting to consider how the regulatory pluralism could be conceived of in relation to actions against insolvency practitioners.

Just as Ayres and Braithwaite's pyramid lends itself to being adopted in a public insolvency practitioner context, private enforcement options can be projected onto it. The bottom layer of such a private compliance pyramid would pertain to reputational risk and involve voluntary compliance with obligations in order to avoid reputational harm that could flow from private suits against the insolvency practitioner. A second layer, equivalent to Ayres and Braithwaite's so-called 'warning letter', would be represented by accountability to creditors in the form of, for example, the power that creditors have to request the liquidator to convene meetings of creditors,[91] or to give the liquidator particular instructions.[92] The ability to apply to the court to have the liquidator removed could provide a potential third layer.[93] The last 'active' layer of the pyramid would then be reflected in private actions that could be brought by third parties who suffered harm as a result of non-compliance with obligations on the part of the insolvency practitioner. Plaintiffs in a private suit clearly would not have the power to *act* to suspend or cancel the registration of a liquidator. However, at the apex of the pyramid could be the unavoidable consequence, in particularly egregious cases that a liquidator may no longer be able to practise, for example, as a result of mandatory indemnity and liability insurance becoming impossible to afford.[94] Private actions against

89 Corporations Act 2001 (Cth) s 1317P. The conduct giving rise to criminal liability may be the same as the conduct that formed the basis of the civil action. The state of mind of the defendant is relevant, as indicated by the reference to 'reckless' and 'intentionally dishonest' in s 184, providing for criminal liability in case of a breach of particular duties.

90 OECD, above n 83, p 76. A number of authors note the ability of private litigation to complement public regulation with the aim of pursuing poicy objectives. See, eg, E Chamblee Burch, 'Securities Class Actions as Pragmatic *Ex Post* Regulation' (2008) 43 *Georgia L Rev* 63 at 74; L Dalla Pellegrina and M Saraceno, 'Securities Class Actions: A Helping Hand for Bank Regulators in Trouble', (2011) 7 *Review of Law and Economics* 219 at 220.

91 Corporations Act 2001 (Cth) ss 470(2), 506(1)(b).

92 Corporations Act 2001 (Cth) s 479(1)).

93 Corporations Act 2001 (Cth) ss 473(1), 503.

94 See para 2 below for further discussion on insurance requirements.

liquidators may also 'trigger' public regulatory measures and ASIC could possibly decide, as a result of a successful private action against a liquidator, to apply to the Companies Auditors and Liquidators Disciplinary Board for the suspension or cancellation of the liquidator's registration.[95]

## C Relationship between public and private regulatory measures

As discussed above, the concept of regulatory pluralism offers theoretical support for 'private' regulation of insolvency practitioner behaviour. There are a range of considerations that could influence the relationship between public and private regulatory measures. These include the advantage in knowledge, the ability to compensate, no 'real' threat of civil litigation and costs.[96] Such factors serve as a basis for the discussion that follows. Some factors appear to militate against the efficacy of private enforcement actions. However, recent developments, particularly in relation to funded class actions, could overcome a number of these obstacles.

### 1 Advantage in knowledge

A clear benefit of private enforcement is that private parties are often in a better position to identify risk and estimate the nature of the risk.[97] This 'inherent advantage in knowledge'[98] means that private parties, such as creditors, could be better positioned to 'police' the activities of insolvency practitioners, compared to the public regulator. A public regulator would in many instances not be able to obtain comparable information, as it would require continuous observation of parties' behaviour.[99]

### 2 Ability to compensate

A potential limitation on the efficacy of private regulatory measures could be an inability to compensate.[100] This point is particularly relevant insofar as private actions against delinquent insolvency practitioners are concerned. From the perspective of third parties who suffered harm as a result of clear wrongdoing on the part of the insolvency practitioner, eventual success in obtaining judgment against that practitioner may be worth very little if the insolvency practitioner is unable to compensate those who suffered harm. An inability to compensate could ultimately serve as a disincentive to institute proceedings against the insolvency practitioner.

Liability insurance could play an important role in this regard. Section 1284 of the Corporations Act 2001 (Cth) requires registered liquidators[101] to

95 In terms of the Corporations Act 2001 (Cth) s 1292(2).
96 S Shavell, 'Liability for Harm versus Regulation of Safety' (1984) 13 *Jnl of Legal Studies* 357 at 358 identified these four aspects in his study on factors that could influence the 'relative desirability of liability and regulation'.
97 Ibid, at 360.
98 Ibid.
99 Ibid.
100 Ibid.
101 These requirements in effect apply to administrators as well, since the Corporations Act 2001 (Cth) stipulates that administrators must be registered liquidators.

maintain 'adequate and appropriate professional indemnity insurance'[102] and 'adequate and appropriate fidelity insurance'[103] for claims that may be made against them. Significant amounts could potentially be available for compensation as a result, as illustrated by ASIC's policy on s 1284, set out in Regulatory Guide 194.[104] According to ASIC's policy, professional indemnity insurance, for example, must meet the quantum requirement as formulated under the Professional Standards Act 1994 (NSW).[105] However, it has to be conceded that s 1284, for a number of reasons, does not provide any kind of certainty that a liquidator would be able to compensate those prejudiced by his or her misconduct.[106] First, enforcement of this provision appears to be problematic and criticism has been levied against ASIC's approach of waiting for confirmation in an annual statement by liquidators that practitioners have adequate insurance and also against the fact that non-compliance does not carry a penalty.[107] A further problem that has been identified is that not all policies provide run-off cover as advocated by ASIC.[108] Lastly, even if insurance is in place, it may not provide cover against all types of wrongdoing — deliberate wrongdoing and fraud would, for example, not be included.[109]

Mechanisms to ensure compliance with these provisions are in need of tightening up to ensure that liquidators have the necessary insurance in place. Various suggestions have been made to address this aspect, for example attaching criminal sanctions to not holding the necessary insurance,[110] or requiring insurers to notify ASIC of lapses or non-renewals of practitioners' policies.[111] It has also been suggested that insolvency practitioners should be members of professional organisations and that each of these organisations

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102 Corporations Act 2001 (Cth) s 1284(1).
103 Ibid, s 1284(1)(b).
104 ASIC, *Insurance Requirements for Registered Liquidators*, Regulatory Guide 194 (RG 194) issued 26 June 2008, based on legislation and regulations as at 1 July 2008, at <http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg194.pdf/$file/rg194.pdf-187k-[pdf]> (accessed 13 September 2011).
105 In adopting the Institute of Chartered Accountants of Australia (ICAA) (New South Wales) Professional Standards Council (PSC) scheme as a guide, ASIC's policy broadly stipulates that the sum insured for each claim, and for all claims in the aggregate must not be less than the lowest of: $20 million; or 10 times the highest gross fees billed by the registered liquidator in a single financial year in relation to a particular insolvency engagement; or, in instances where the registered liquidator has provided insolvency services for less than 1 full year immediately before the financial year in which the registered liquidator's or their firm's insurance policy period commences, $750,000, where the registered liquidator's or their firm's insurance policy period commences on or before 30 June 2009, or $1 million where the registered liquidator's or their firm's insurance policy period commences after 1 July 2009.
106 As is illustrated in the case of Mr Ariff, whose insurance policy lapsed before various claims of creditors were made.
107 Senate Inquiry Report, above n 1, at [7.28]–[7.32].
108 Ibid, at [7.35]–[7.36].
109 Ibid, at [7.37]. In the case of Mr Ariff, for instance, this would mean that even if his insurance had not lapsed, creditors would still not have been covered.
110 Name withheld, *Submission 93*, p 1, as referred to in the Senate Inquiry Report, above n 1, at [7.32].
111 Prof Scott Holmes, *Submission 21*, p 25, as referred to in the Senate Inquiry Report, above n 1, at [7.31].

should have a fidelity fund to provide cover against fraud.[112] Suggestions in the proposals paper include raising the current penalty from 5 to 1000 penalty units for not maintaining adequate and appropriate professional indemnity insurance and also the attachment of proof of insurance to the annual practitioner return that has to be lodged.[113]

From a broader perspective, the availability of indemnity and fidelity insurance may be attacked from a regulatory point of view. It could be argued that the existence of such insurance detracts from the deterrent value of possible private litigation, thus strengthening the argument in favour of public regulation. The counter-argument is that the deterrent value of private litigation lies not only in the threat of compensation liability, but also in the reputational damage that could follow as a result. In addition, there could be a potential impact on the practitioner's ability to obtain such insurance, or the conditions under which such insurance could be obtained, in cases where a third party was successful with a private action against the practitioner. The inaffordability of the required indemnity and fidelity insurance may very well signal the end of a practitioner's career.

### 3 No 'real' threat of civil litigation

A further potential limitation on the efficacy of private actions is the fact that wrongdoers may not in actual fact have to face the threat of civil litigation for harm done.[114] This could occur where the harm generated is widely dispersed, making it difficult for individuals to initiate legal action.[115] In the insolvency practitioner context, it may be that the claim of any individual plaintiff may be too small to justify the expense of bringing an action against the liquidator. However, recent developments here in relation to class actions may have altered the landscape permanently. The ability of class actions to enable aggregation of claims against a liquidator, may make otherwise unviable actions tenable.[116] The regulatory power of the 'civil litigation threat' is enhanced significantly.

### 4 Costs

A final perceived limitation on the efficacy of private actions is the costs involved. Although private actions may shift the cost burden from the public regulator,[117] costs remain a disincentive in the private sphere as well.[118] Here, the development of an active litigation funding market in Australia in recent years (coupled with increased class action activity) is likely to impact

112 Name withheld, *Submission 93*, p 1, as referred to in the Senate Inquiry Report, above n 1, at [7.37].
113 Proposals paper, above n 8, p 25.
114 Shavell, above n 96, at 363.
115 Ibid.
116 A discussion on the legislative framework which could facilitate the bringing of class actions against liquidators is beyond the scope of this paper. This particular aspect was addressed by the authors in an article titled 'Class Actions in an Insolvency Practitioner Context', reference provided above n 76.
117 Shavell, above n 96, at 363–5.
118 Although, from a policy point of view, it may be argued that this is a more appropriate place for the cost to lie, rather than having the public underwrite and subsidise the relevant actions.

significantly.[119] Use of litigation funders in insolvency matters has been described as 'quite common'.[120] While litigation funding has to date only been harnessed by liquidators to support actions,[121] there seems no reason in principle why aggrieved creditors could not similarly rely upon this mechanism.[122] It is probable that litigation funding, as it continues to evolve, will seek new avenues of growth for its successful business model.[123]

## IV Conclusion

The undesirable consequences of weak controls over the conduct of insolvency practitioners have been warned against in a submission to the Senate Inquiry:

> Insolvency professionals are more likely to act opportunistically and in their self-interest to the detriment of third parties when the regulatory framework settings are weak . . . When ASIC cannot or will not act against the repeated misdemeanours of major accounting and insolvency firms . . . do not be surprised if a culture of fearlessness spreads throughout the industry and gambles are taken on white collar crime.[124]

This article demonstrates that existing principles of law offer a wide variety of bases for the bringing of private actions against liquidators. Furthermore, it is apparent that a range of claimants may have standing to bring those actions. At its simplest, a private action against a delinquent insolvency practitioner provides a means to compensate those who suffered harm as a consequence of the insolvency practitioner acting in breach of his or her obligations.

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119 As a result of the High Court decision in *Campbell's Cash & Carry v Fostif Pty Ltd* (2006) 229 CLR 386; 229 ALR 58; [2006] HCA 41; BC200606677 the common law rules against champerty and maintenance were effectively abolished. This left the door open for litigation funders to become involved in the funding of actions for claims. The practice of class action litigation involving litigation funders was dealt a serious blow by the Full Court of the Federal Court in *Brookfield Multiplex Ltd v International Litigation Funding Partners Pty Ltd* (2009) 256 ALR 427; 71 ACSR 588; [2009] FCA 450; BC200903525, with the court holding that the funding arrangements in a shareholder class action constituted a managed investment scheme that required to be registered under the Corporations Act 2001 (Cth). Minister for Financial Services, Superannuation and Corporate Law, Chris Bowen MP, announced on 4 May 2010 that the Federal Government would draft regulations which will exclude funded class actions, and similar arrangements, from the definition of managed investment schemes in the Corporations Act 2001 (Cth). The impact of litigation funding on litigation is recognised by commentators as well. See, eg, R Baxt, 'Litigation Funding at another Cross-roads' (2009) 27 *C&SLJ* 255 at 255 and also R Baxt, 'Litigation Funding: Crossing the "Cross Roads"' (2010) 28 *C&SLJ* 54 at 57, who regards litigation funding as now 'form[ing] part of the fundamental mechanisms available to claimants seeking retribution'.

120 See Law Council of Australia, *Litigation Funding*, 14 September 2006, p 7, at <http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uuid=8C744AB2-1C23-CACD-2297-5D181CEBB545&siteName=lca> (accessed 19 January 2011).

121 As, for example, in *Hall v Poolman* (2009) 254 ALR 333; 71 ACSR 139; [2009] NSWCA 64; BC200902007.

122 Brand, Lombard and Fitzpatrick, above n 76, at 232.

123 A business model which appears to be very effective. Lim, above n 74, at 137, notes that litigation funder IMF (Australia) Ltd reported enjoyed a return on invested capital of 114% for the financial year ended 30 June 2009.

124 Mr J Knapp's submission to the Senate Inquiry, *Submission 86*, p 2, referred to by the Senate Inquiry Report, above n 1, p 65.

However, it is clear that, from a broader perspective, private enforcement actions against delinquent insolvency practitioners also have the potential to fulfil an important regulatory function — an idea which is supported by the concept of regulatory pluralism. In this context, recent developments in the law, specifically the increase in class actions and the involvement of litigation funders, could overcome what would appear to be obstacles in the way of private enforcement. It is true that this process depends on the availability of financial resources and for that reason could not act as a 'replacement' for public regulation, but it remains able to fulfil a valuable complementary regulatory function. Ultimately, by incorporating private actions against delinquent insolvency practitioners into the broader regulatory framework, regulation may be better able to effectively realise policy objectives.