

CITY INSOLVENCY

DISCUSSION GROUP

Wednesday, 1 May 2019

TOPIC

'Remuneration: it doesn't grow on trees'

PRESENTED BY

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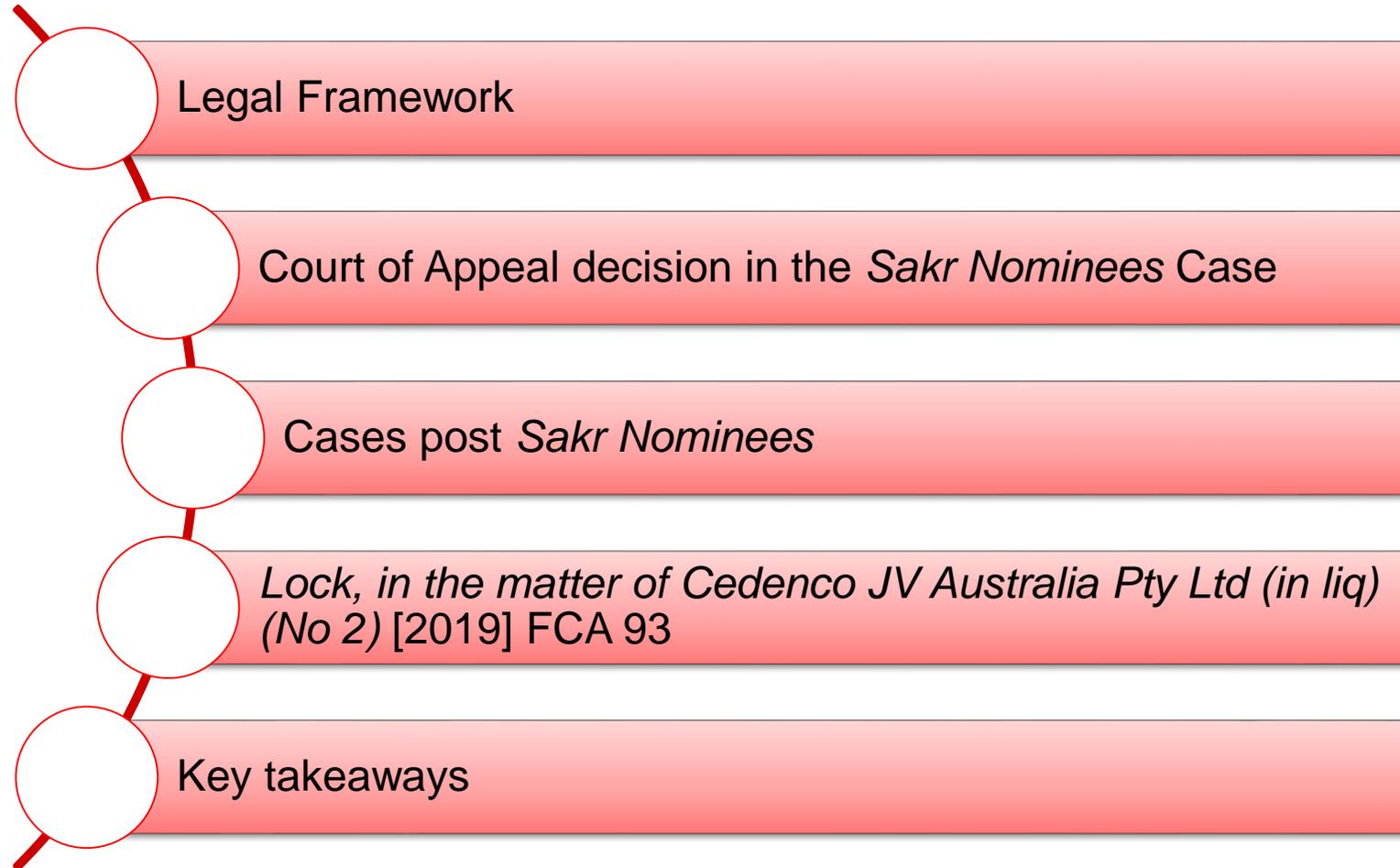
Remuneration: it doesn't grow on trees

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Overview



Legal framework

Receivers

- Private appointment: usually determined under security agreement/as between appointor and receiver
- S425 CA: Court may fix a receiver's remuneration on application of liquidator, administrator, ASIC or the receiver
 - Whether the remuneration is reasonable
 - Consideration of certain factors

External administrators

- Div 60 IPS: External administrators entitled to receive remuneration “for necessary work properly performed”
- Determined by:
 - resolution of creditors;
 - Committee of inspection; or
 - the Court
- S60-12 IPS:
 - Whether remuneration is reasonable
 - Consideration of certain factors

Legal framework

What is “reasonable”?

Section 425(8) CA (receivers)
Section 60-12 IPS (external administrators)

The Court *must* have regard to whether the remuneration is reasonable, taking into account any or all of the following matters:

- extent to which work by the external administrator was **necessary** and **properly performed**;
- **period** during which the work is performed;
- **quality** of work performed;
- **complexity** of work performed;
- extent to which **extraordinary issues** may arise;
- extent to which required to accept higher level of **risk** or **responsibility**;
- **value** and **nature** of the property to be dealt with;
- **number, attributes** and **conduct** of the creditors;
- if remuneration is worked out on a time-cost basis – the **time properly taken**;
- whether will deal with one or more **controllers**;
- any **review** undertaken in respect of the remuneration; and
- any **other** relevant matters

Legal framework

Calculation of remuneration

ARITA Code: Part 15, principle 11

Time based charging – charging at hourly rates

Prospective fee approval – the hourly rate at a capped amount

Fixed fee – quoted fixed amount

Percentage – percentage of particular factor

Success/contingency fees – bonus if particular circumstances arise

Judicial divergence pre *Sakr Nominees*

Brereton J line of decisions

- Preferred value based or *ad valorem* approach
- Consideration of proportionality
- Incentivises creation of value rather than disproportionate expenditure of time

Black J line of decisions

- Did not accept proportionality approach as the touchstone for the measurement of remuneration – accepts time-based approach (within limits)
- Value based approach can be used to test the reasonableness of the hourly rate claimed and identify cases in which there ought to be concern in that respect
- The difficulties involved with time-based remuneration, particularly at standard hourly rates, will be more acute in smaller liquidations

Court of Appeal – *Sakr Nominees*

Background

- Only significant asset was land realised for \$3.72 million
- Creditors approved liquidators remuneration - \$197,000
- Liquidators sought Court approval for additional remuneration - \$63,500
- Brereton J awarded additional remuneration of only \$20,000
 - applied the ad valorem approach
 - reasonable remuneration ought not be assessed by reference only to time reasonably spent at standard rates

Court of Appeal decision

- Overturned Brereton J's decision:
 - seemingly no consideration given to the value of additional work in fixing the remuneration
 - did not appear to take into account evidence presented by the liquidator
 - did not appear to have considered the factors set out in the Corporations Act

Court of Appeal – *Sakr Nominees*

Takeaways from Court of Appeal decision

- Onus is on the external administrator to establish that remuneration is reasonable
- Not appropriate to fix remuneration simply by applying a percentage
- Value based approach is still relevant – the question of proportionality is a well-recognised factor for the Court to take into account
- Endorsed Black J's approach in *Re Idyllic Solutions* – percentage that remuneration constitutes of realisations provides a measure of objective testing
- No reason why an external administrator should not be remunerated for work performed in an unsuccessful attempt to recover assets
- To simply apply a percentage without regard to the particular work required would be to pay no regard to the factors in the statutory framework

Cases post *Sakr Nominees* appeal decision

Re Australian Co Number 074 962 628 Pty Ltd (formerly Colonial Staff Super Pty Ltd) [2017] NSWSC 370 (Gleeson JA)

- Endorsed approach of the Court of Appeal in *Sakr* –
 - “plainly, an ad valorem basis is not appropriate given the nature of the liquidation was essentially defensive of the claim against the company”

In the matter of Cardinal Project Services Pty Ltd [2017] NSWSC 920 (Brereton J)

- Applied proportionality approach rather than time based approach
 - regard must be had to the work actually done, but by no means does that mean that the Court would necessarily approve remuneration on a time cost basis
 - applied the proportionality approach – remuneration comprised approximately 26% of the recoveries generated

In the matter of Banksia Securities Limited (in liq) (recs & mgrs apptd) [2018] NSWSC 229 (Black J)

- Endorsed approach of the Court of Appeal in *Sakr* –
 - applied the time based approach more favourable for the debt holders
 - commented on the proportionality approach – the remuneration claimed represents a small proportion of the recoveries received – as a measure of objective testing of the reasonableness of the time based claim.

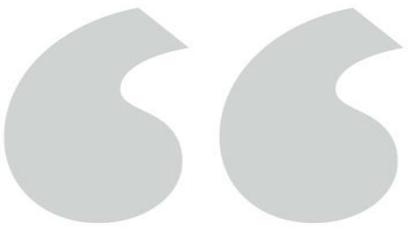
Cases post *Sakr Nominees* appeal decision (cont)

Australian Executor Trustee Ltd v Provident Capital Ltd [2018] FCA 439 (Rares J)

- Considered proportionality and the engagement of consultants

Re Western Port Holdings Pty Ltd [2018] VSC 352 (Matthews JR)

- Importance of evidence put before the Court



It is important... that appointees in the position of receivers actively consider, so that they can later demonstrate to the Court, the adoption of a reasonable approach calculated to minimise the costs of the employment or engagement of persons including themselves and their staff, to perform work for the benefit of the estate. ... Receivers (or liquidators) ordinarily, should select the means for performing the work required to discharge their duties that will cause the least financial burden on the estate.

(Rares J in *Australian Executor Trustee Ltd v Provident Capital Ltd* [2018] FCA 439 at [77])



Lock, in the matter of Cedenco JV Australia Pty Ltd (in liq) (No 2)
[2019] FCA 93

Court Wallops Liquidators Over \$5.8 Million In Fees

<https://insolvencynewsonline.com.au/court-wallops-liquidators/>

Lock, in the matter of Cedenco JV Australia Pty Ltd (in liq) (No 2) [2019] FCA 93

- Liquidators of three Australian entities in the SK Foods Group applied to Court:
 - under s1322(4)(a) to fix their remuneration due to “procedural irregularities” with the approval obtained; or alternatively
 - an application under ss 449E(7) and 511 for the Court to fix remuneration.
- ASIC raised concerns with the Liquidators as to the approval of remuneration of ~\$5.7M including:
 - resolutions being passed without any remuneration report being provided to creditors;
 - inadequate remuneration reports; and
 - hourly rates charged.
- ASIC intervened in the proceedings and adduced evidence, cross examined witnesses and made detailed submissions.

Lock, in the matter of Cedenco JV Australia Pty Ltd (in liq) (No 2)

[2019] FCA 93

ASIC criticised:

- Generic descriptions of work undertaken despite the amount of remuneration claimed
- Unclear which staff member completed each task and at what hourly rate
- The inaccuracy of the reports – for eg claiming for application to extend the convening period in liquidators reports

By way of example, March 2012 meeting - ~\$2.2M claimed for 3,800 hours of work:

- One page summary of hours spent
- Substantive part of each remuneration report was 2 pages in length
- Time and charges are divided between broad categories with generic descriptions which are largely identical to the descriptions in the earlier remuneration reports
- Included descriptions of work that could not be undertaken in that time period including “Preparing 439A Report”

Lock, in the matter of Cedenco JV Australia Pty Ltd (in liq) (No 2)

[2019] FCA 93

- Besanko J found that each of the reports provided failed to satisfy the requirements of the Act and:
 - fell “well short” of the requirement to give creditors sufficient information to make an informed assessment of the reasonableness of the remuneration proposed; and
 - included information which was not only wrong but which added to the impression of a lack of care of describing the tasks undertaken in a meaningful way
- Due to the deficiencies in the reports, Besanko J ultimately held that each of the resolutions approving remuneration was invalid.
- Accordingly remuneration needed to be:
 - fixed pursuant to an order made under s1322(4) (*Irregularities*); or
 - reviewed and fixed by the Court.

Lock, in the matter of Cedenco JV Australia Pty Ltd (in liq) (No 2)

[2019] FCA 93

In determining whether the liquidators were entitled to have their remuneration approved under s 1322(4)(a) Besanko J considered 3 questions:

1. Did the Liquidators act honestly?

- Yes. Besanko J found that the liquidators acted with a lack of care, but they acted honestly.

2. Had substantial injustice been caused or likely to be caused?

- ASIC argued that substantial injustice had been caused because creditors were denied the opportunity to consider and assess the remuneration claims in a meaningful way. Besanko J agreed.

3. Was there any other reason that not to make an order?

- The contraventions were not trivial or inconsequential.
- The liquidators remuneration did not appear, at least on a prima facie basis, to be reasonable.

Lock, in the matter of Cedenco JV Australia Pty Ltd (in liq) (No 2) [2019] FCA 93

ASIC Evidence

- Hourly charge out rates of 10 firms
- In July 2010 rates were increased:
 - Partner - 33%
 - Senior Manager by 22%
 - Associate by 40%.
- Also compared the level of experience and position titles across firms

Besanko J found that rates were excessive and fell outside of the band of reasonable remuneration.

Annexure A

MARKET RATES FOR INSOLVENCY PRACTITIONERS – 2010

Firm	Hourly rates (\$)		
	Manager	Senior Manager	Partner
Sheahan Lock Partners	450	550	700
PPB Advisory (Large & Complex)	455	500	625
Korda Mentha	400	450	625
BDO	420	465	595
PPB Advisory (General)	425	465	590
McGrathNicol	395	420	570
Grant Thornton Australia	380	415	525
BRI Ferrier	360	380	495
Meertens Chartered Accountants	386	425	495
Smith Hancock	310	390	470
Hayes Advisory	No data	No data	No data

Average hourly rates by firm size (excluding Sheahan Lock Partners)

Firm size	Average hourly rates (\$)		
	Manager	Senior Manager	Partner
Medium to large firms	405	442	575
Boutique firms	348	408	483
Overall	392	434	554

Lock, in the matter of Cedenco JV Australia Pty Ltd (in liq) (No 2)

[2019] FCA 93

ASIC Evidence

- Expert evidence from Peter Gothard, Managing Partner at Ferrier Hodgson in Sydney:
- Would a “**competent and prudent insolvency practitioner**” (CPIP) have carried out the work in respect of which the Practitioners claim remuneration
- If so:
 - (a) to what extent would a CPIP have carried out the work?
 - (b) would a CPIP have carried out the work deploying persons of the apparent seniority as deployed by the Practitioners?

Lock, in the matter of Cedenco JV Australia Pty Ltd (in liq) (No 2)

[2019] FCA 93

- Hourly rates to be reduced by:
 - 20% in respect of Partners and Senior Managers
 - 10% for Managers
- Remuneration for some work streams to be cut, including:
 - No remuneration allowed for preparation of remuneration reports (ie 100% discount)
 - 50% write off on time for preparing reports to creditors
 - 65% reduction on a particular work stream that was not beneficial to the winding up (after the hourly rate reduction)
 - 50% write off for preparing ASIC forms and minutes of meetings
- Total remuneration is yet to be fixed – significant reduction expected

Key takeaways

- One size does not fit all
- If a time based approach is adopted, the proportionality approach will provide a measure of objective testing the appropriateness of the time based charging.
- Remuneration reports should explain the work undertaken and the complexity and difficulties faced
- Practitioners should have detailed narrations in time sheets, WIP Reports should be carefully reviewed and remuneration reports must be accurate and provide enough information for creditors to make an informed decision about the reasonableness of remuneration claimed
- External administrators cannot necessarily rely on s1322 to have remuneration “rubber stamped”
- If the Court is to determine remuneration, expect the examination to be thorough and the evidence of peers may be admissible
- Even if creditors do not seek to review or challenge remuneration, ASIC might

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Next CIDG Session

Wednesday, 5 June 2019



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