

# INSOLVENCY PRACTITIONERS ASSOCIATION OF AUSTRALIA

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### Some Remarks on the Launching of the Code of Professional Practice

By Justice RP Austin, Supreme Court of New South Wales

The last time I addressed a conference of this Association was in Brisbane in October 2006, when I spoke about the legal standard of loyalty and professional guidelines. Your president at that time introduced and welcomed my fellow speakers and me. It was an articulate welcoming address except for his closing remarks when, in a rush of slightly tongue-twisted enthusiasm, he told the audience, "I would like to spank the speakers". On that occasion I was able to escape unscathed, clutching my complimentary T-shirt, which was emblazoned, "Insolvency Practitioners Do It With Integrity". I am not sure of the fate of the other speakers.

And so I come before you today with a modicum of apprehension. Forgive me if I occasionally glance over my shoulder.

On the last occasion I made the obvious point, echoing some remarks a few years earlier by Professor Ron Harmer, that the professional association for insolvency practitioners should actively assist its members to appreciate and perform their duties, including in particular their duties of loyalty, impartiality and independence. This was for three reasons. First, the professional body could offer its members the "corporate" wisdom and experience of the profession. Secondly, the development of appropriate standards and guidelines could well influence the regulators and even the courts, who would be prepared, in all probability, to take responsible professional guidelines into account when evaluating a practitioner's conduct in a particular case. Thirdly, if the professional association was perceived not to be establishing adequate standards, faithfully observed by its members, it would be inevitable that additional standards would be enacted by law, probably highly prescriptive, detailed and complex standards which would not necessarily take into account the practicalities of daily insolvency work.

The last point deserves emphasis. The advantages of self-regulation as a regulatory strategy are well documented (see, for example, John Braithwaite, "Enforced Self-Regulation: A New Strategy for Corporate Crime Control," (1982) *Michigan Law Rev* 1466). But as soon as self-regulation is perceived to be ineffective, public opinion turns against it rapidly, for poor self-regulation tends to be equated with self-interest. The United Kingdom experience with self-regulation in the financial services industry in the 1980s is a chilling illustration of what can occur.

The Financial Services Act 1986 was enacted after the Big Bang of the London Stock Exchange and the opening up of the UK financial services industry to foreign

banks. The legislation followed recommendations by Professor LCB Gower, a prominent corporate law expert, who was instructed by the Thatcher Government to avoid the establishment of "yet another quango" (ie, the Government did not want recommendations for a US style Securities and Exchange Commission). So Professor Gower recommended a system in which there were about a dozen self-regulatory bodies supervised by the Securities and Investment Board. But the system was dissolved with the enactment of the Financial Services and Markets Act 1999 because of a series of scandals, including the theft of assets from the Maxwell company pension funds, improper sale of home income plans to elderly investors, some unseemly goings-on at the London Fox futures market, the collapse of Barings Bank, the mis-selling of personal pensions and some irregularities at Morgan Grenfell's European Growth Unit Trusts. Those advising the UK Government took the view that these problems reflected failure of the self-regulatory organisations to discharge their regulatory responsibilities, in circumstances where their members were not adhering to the applicable self-regulatory requirements. Their monitoring had been too mechanistic and they had treated the information that they received uncritically, and had failed to act quickly enough (see House of Commons Research Paper 99/68, 24 June 1999, pages 7-11; Kevin Dowd, *Money and the Market: Essays on Free Banking* (Routledge, 2001), ch 17). In consequence, the legislation of 1999 established a public regulatory body, the Financial Services Authority, and imposed public regulation on the industry. In Australia, failure of self-regulation for the insolvency profession will mean more active and comprehensive regulation by ASIC.

In October 2006 I had some critical remarks to make about the Code of Professional Conduct that had been promulgated by the IPA in May 2001, and the Statements of Best Practice relevant to the duty of loyalty, such as the statement on Independence (July 2003). I urged the adoption of clearer, more principles-oriented guidelines that distinguished between what was desirable and what was obligatory.

Now the IPA has produced a handsome and detailed new Code of Professional Practice, to be launched this morning. It would be inappropriate for me to make an assessment of the content of the new Code, by reference to the criteria established in my 2006 paper or any other criteria. I have to keep in mind the prospect that in some future case I will be asked to rule on the reasonableness or appropriateness of some provision of the Code, and I must preserve the capacity to approach that issue impartially. I can say, however, having had the opportunity to review self-regulatory codes in various professional contexts over the years, that this Code is very impressive for its structure, clarity and practicality.

The Code states principles governing the insolvency profession's work in a straightforward and simple way. The importance of a clear and simple articulation of governing principles must not be underestimated. When you delve into the details of the Code, it will be helpful to refer back to the relevant principle and keep it in front of mind. But life in any profession is not always simple and straightforward, and professionals need guidance as to how to apply the principles of their code of conduct to the complexities of real situations. And so the Code goes beyond the statement of principles and presents detailed guidance and examples, as well as templates and practice notes. That necessarily makes for a long document. The present version runs for over 100 pages. It may be possible further to simplify and

reduce the document in future, but not, I suspect, by much. There is no avoiding the inevitable: insolvency practitioners will have to read and then master this document; indeed it will be a mark of their professional status that they do so.

The range of subjects addressed by the Code appears to me to be comprehensive. For a lawyer, it is impossible to avoid making comparisons with the legal profession. After articulating the principles governing conduct, remuneration and practice management, the Code gives detailed guidance on independence, communication, timeliness, remuneration and other matters. Let me briefly supplement the Code with some lessons from the legal profession.

As to communication, it is essential not only to supply clear and pertinent information, but also to ask the right questions. An English criminal defence solicitor has recorded this interview with a client:

Are you using drugs?

No.

Do you drink alcohol?

Yes.

Have you had a drink today?

Yes.

Do you drink every day?

Yes.

When you drink, do you always become intoxicated?

Yes.

Do you consider yourself to be an alcoholic?

Yes.

Have you sought help with your drinking?

No, I drink it all myself.

As to timeliness, we are all aware of some uncomfortably long liquidations. I have reason to notice these because they corrupt our court statistics on the speed of completion of litigation. But these long liquidations are merely the fluttering of a butterfly's wings compared with legal delays in India. The author Christopher Kremmer reports, in his book *Inhaling the Mahatma*, that India holds the record for the most protracted lawsuit ever adjudicated, a dispute over control of a Hindu temple in Pune that went to court in AD 1205 and was finally concluded in 1966. Even in modern times, on average it takes 10 years for a court case to be completed in India. In October 2004 the Delhi High Court ordered a 55-year-old bank clerk who had been sacked 30 years earlier to be reinstated, enabling him to work for 5 years before his retirement. Hopefully, with the assistance of the Code, the Australian insolvency profession can do much better than this.

As to remuneration, the Code makes many points, one of which is that a practitioner is entitled to remuneration only in respect of work done that was necessary for the administration. Lawyers also pay lip service to this principle, but there might be some debate about what is necessary work. In a recent address to a LawAsia conference, the Chief Justice of Hong Kong gave the instance of a client who asked his lawyer for a breakdown of his bill. The itemised account included a charge for "recognizing you in the street and crossing the busy road to talk to you to discuss your affairs, and re-crossing the road after discovering it was not you."

During my 40 years in the law, the legal profession's work has developed greatly in the commercial area. But I am sure the development of the legal profession has been minor compared with the rapid evolution of the insolvency profession. The Code is expressed to apply to all members of the IPA in so far as they conduct or are involved in the administration of insolvencies, formal and informal. The words "formal and informal" are important. 40 years ago insolvency practitioners were accountants who specialised in bankruptcy or corporate winding up, and in the latter category, included those on the Supreme Court's rotation list. There were some specialist receivers, typically partners in accounting firms. Altogether, it was a small band. During the last 40 years we have seen exceptional growth, not only in specialist insolvency firms and specialist branches of accounting firms, but also in the nature and scope of the work. Most importantly, the profession moved into voluntary administration in the 1990s, opening up not only new work, but also new ways of doing and acquiring business. Now the profession is moving into informal "turnaround" or "workout" assignments, particularly in the corporate area. In offering themselves as experts in turnarounds, insolvency professionals put themselves in competition with a range of financial experts, perhaps most notably investment banks and private equity. In particular, in the current economic circumstances the appetite of private equity for turnaround work is not to be underestimated.

What can insolvency practitioners do to give themselves an edge in competition with others for turnaround work? In my view a substantial part of the answer is this: insolvency practitioners are professionals, and as such they can command a level of confidence from clients and creditors that would not be given to other financial engineers. What is it that makes insolvency practitioners "professionals" deserving of special confidence? The answer, in my view, lies between the covers of the Code of Professional Practice. In the language of the Chief Justice of Hong Kong: "The virtue of [a] profession, which distinguishes it from a business, is that in its practice, the selfish pursuit of economic success is tempered by adherence to ethical standards and a concern for the public good". These are not mere words of exhortation. Their validity is tested by the presence, amongst practitioners, of sound ethical and professional standards, not only proclaimed but in fact adhered to on a rigorous and daily basis.

In my view the establishment of a comprehensive Code of Professional Practice marks the maturity of the insolvency profession and has the potential to distinguish insolvency practitioners from other operatives in the insolvency area. That potential will be realised if the Code is followed and enforced.

That leads me to a topic of great importance. No matter how elaborate and impressive the text of a code of conduct might be, it is worse than useless if it is filed away and disregarded in everyday practice. Worse than useless because, if the conduct of a practitioner is challenged in court, the practitioner will be cross-examined along these lines:

Have you heard of the IPA Code of Professional Practice?

Do you have a copy of it?

Have you read it recently?

What have you done to ensure that you and your employees comply with it?

If these questions are not answered satisfactorily, the practitioner can only expect the gravest consequences.

What is needed, therefore, is for insolvency practitioners both to master the Code themselves, and to take appropriate steps to ensure that it is a living instrument governing their conduct and the conduct of everyone in their firm. This can only be done if steps are taken, structured around the adoption of the new Code, to inject into the firm a culture of compliance. Those steps would include tuition, discussion, and leading by example. If the firm is of significant size, they would include the establishment of a compliance system, with regularly tested protocols for identifying issues and ensuring they are dealt with at the right level within the organisation.

You might infer, correctly, that the task is large, possibly even daunting. But you can take encouragement from the fact that the principles you are asked to adhere to generally reflect sound common sense and a sense of doing things in the proper way. I wish you well in your endeavours.

Let me conclude by reminding you of one matter of basic common sense. Before you sign off on a document, be it a report to creditors, or financial statements, or the text of a deed of company arrangement, it is a very good idea to read the document yourself. It is depressingly common for judges to find that the contents of such documents have been simply lifted from precedents, without proper review. When, however, you review the document, you must make absolutely sure that it contains clause 10.4. Clause 10.4 is so important that it was recently published in England in the *Times Online*. It is as follows:

**"10.4 End of the world.** Upon the occurrence of the end of the world ... the notes and drafts, at the option of the required banks, will become immediately due and payable in full and may be enforced against the company by any available terrestrial, extraterrestrial or spiritual procedure. For remedial purposes ... the company, by virtue of its attorneys, will be deemed to be aligned with the forces of light, and the banks and their attorneys will be deemed to be aligned with the forces of darkness, regardless of actual ultimate terrestrial, extraterrestrial or spiritual destinations of the company or the banks or any of their particular officers (including, without limitation, the Treasurer and the Vice President-Finance)."