

# Remember remuneration report requirements

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## Summary

The importance of complying with the statutory requirements in relation to remuneration reports to creditors was recently highlighted in the decision of *Lock, in the matter of Cedenco JV Australia Pty Ltd (in liq) (No 2) [2019] FCA 93* wherein the Federal Court of Australia found that the failure of the two liquidators to provide sufficient detail in a remuneration report to creditors invalidated previously approved remuneration.

## Background

Between 2010 and 2014, Mr Russell Lock ('**Lock**') and Mr John Sheahan ('**Sheahan**') were the joint and several administrators, and then liquidators, of several related companies.<sup>1</sup>

Between August 2010 and October 2013 Lock and Sheahan purported to receive remuneration for their work following a number of resolutions from creditors of the companies.

However, in 2015 it was found that Lock and Sheahan failed to comply with the requirements pursuant to section 449E(7) of the Corporations Act 2001 ('**Act**') (which has now been replaced with section 70-45 of the *Insolvency Practice Rules (Corporations) 2016*).

This section requires that administrators and liquidators prepare a report which sets out matters which will enable a company's creditors to make an informed assessment with regards to proposed remuneration. A copy of such report must then be given to each of the company's creditors at the same time as the creditors are notified of the relevant meeting of creditors.

The failure of Lock and Sheahan to comply with the statutory requirements meant that the previously approved remuneration was considered invalid.

Lock and Sheahan made an application to the Court pursuant to section 1322(4)(a) of the Act on the basis that their remuneration was not invalidated by any non-compliance with the Act and asked, in the alternative, for the Court to determine appropriate remuneration.

ASIC intervened in the proceedings and played a major role by tendering evidence, making a number of submissions and drawing to the Court's attention the fact that Lock and Sheahan were not required to realise assets, had substantial funds paid over to them by the Companies' receivers and managers, and notwithstanding that creditors were paid 100 cents in the dollar, drew remuneration for \$5,787,246.27 excl. GST and incurred legal fees of a similar amount.<sup>2</sup>

## Findings

Justice Besanko found that whilst the plaintiffs had acted honestly in their conduct, their contravention of the Act, in failing to provide adequate reports to creditors, resulted in substantial injustices, as creditors were deprived of the opportunity of meaningful examinations of, and discussions with, fellow creditors about the plaintiffs' fees before the resolution was carried out.

The Court was therefore left with the task of determining the plaintiff's remuneration.<sup>3</sup> ASIC submitted that the total amount of remuneration was unreasonable and excessive, especially with regards to the high hourly rates for partners,<sup>4</sup> the plaintiff's charges for minutes of meetings and remuneration reports, as well as travel arrangements, travel time and work performed by persons of inappropriate seniority.

Ultimately, the Court agreed with ASIC's submissions and found that the remuneration claims were not reasonable. As to the excessive hourly rate, the court found at [313] that:

*"They fall outside the band of reasonable remuneration. The amounts that should be allowed as reasonable remuneration is not capable of precise determination and cannot turn merely on the characterisation of the plaintiffs' firm as boutique or otherwise."*

A 10-20% discount was applied with regards to the plaintiff's hourly rate, and a further discount of up to 65% of fees claimed for various work was applied.

## Conclusion

The failure to provide an adequate remuneration report was an expensive mistake by the Liquidators in this case. Pending an appeal, they will likely surrender a substantial amount in fees.

The Judgment is however a reminder to administrators and liquidators to ensure that they are meeting all the statutory requirements when preparing remuneration reports, which must include, as a *minimum*, information in relation to:

- the matters which will enable the company's creditors to make an informed assessment about proposed remuneration;
- a summary of major tasks performed or likely to be performed; and
- the costs or likely costs associated with each of those major tasks.

A failure to include any of the above information could ultimately invalidate any previously approved remuneration.

An application to the Court to determine remuneration is costly, and may involve a very detailed examination by the Court of the expenses incurred to date. A substantial reduction in remuneration could result.

For creditors, some key take away points are as follows:

1. Consider whether the remuneration report you have received complies with section 70-45 the *Insolvency Practice Rules (Corporations) 2016*. It is worth carefully considering such rules before approving remuneration.
2. Consider the major tasks performed and the explanations provided. If necessary, ask questions about the cost/benefit analysis undertaken before a path was chosen. Are the charge out rates justified? Is the work being performed by a person of the appropriate level of seniority?

For administrators and liquidators, the key take away points are as follows:

1. The best protection against challenges to remuneration is to ensure you are meeting the requirements of the relevant legislation, specifically section 70-45 of the *Insolvency Practice Rules (Corporations) 2016*.
2. Ensure that you are placing great care in the description of the tasks being undertaken and consider whether such description is accurate.<sup>5</sup>
3. Contemplate if hourly rates are appropriate by reference to the market, jurisdiction or risk (here the basis for such high rates (risk) was found not to exist).<sup>6</sup>
4. Consider if you have undertaken a cost-benefit analysis of your actions. If you have, keep an internal record. In the proceeding, the Court appeared to be critical that during certain periods, the Liquidators did not give consideration to approaching the Court for directions or preparing a cost benefit analysis.<sup>7</sup> It would be worthwhile to ask yourself if your decisions will stand up to scrutiny if later challenged by the Court.
5. Prepare work plans and budgets.<sup>8</sup>

6. ASIC intervened here and its submissions were generally accepted by the Court. There may be an increased likelihood of ASIC intervening in future court applications for remuneration approvals, particularly if there is a failure to comply with the relevant insolvency rules.

<sup>1</sup> SK Foods Australia Pty Ltd (in liquidation), Cedenco JV Australia Pty Ltd (in liquidation) and SS Farms Australia Pty Ltd (in liquidation) (SSFA).

<sup>2</sup> At [11] of the Judgment.

<sup>3</sup> The judgment contains a lengthy discussion of what 'reasonable remuneration' is from [273] – [285].

<sup>4</sup> The schedule of hourly rates provided that at the time the partner's rate was \$700 per hour, senior associate was \$550 per hour and manager was \$450 per hour.

<sup>5</sup> See at [82] where the court was critical of a description of a task, being preparation for a court application that had already been claimed.

<sup>6</sup> See [174],[175] and [268] of the Judgment.

<sup>7</sup> See [147] and [184] of the Judgment.

<sup>8</sup> There are numerous references to a lack of preparation of a budget. See in particular [144],[154] and [437] of the Judgment.

## For more information, please contact:



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