

HONG KONG SOCIETY OF ACCOUNTANTS

POSITION PAPER ON OFFICE HOLDERS' REMUNERATION

1. Introduction

- 1.1. The purpose of this paper is to set out the views of the Hong Kong Society of Accountants ("HKSA") in response to issues raised by the Taxing Masters Office ("TM") in relation to remuneration claims submitted by office holders for taxation.
- 1.2. According to the Official Receiver's Office ("ORO"), concern was raised by the TM in relation to the agreement, known as the "Panel A Scheme", between the ORO and the HKSA, and in particular:-
 - 1.2.1. the system of agreed rates under the above agreement, and
 - 1.2.2. the level of the agreed rates
- 1.3. This submission does not address any other issues, but the HKSA will be happy to consider and respond in a positive manner to any other issues which the TM wishes to raise in this or other contexts. The HKSA has already written to the TM on 30 June 2003 more specifically on the issue of the provision of information, in commenting on draft Procedural Guides, which we consider to be interlinked with the above issues.

2. Background

- 2.1. The HKSA's view is that in determining the basis for remuneration of office holders, the starting point should be the time-cost basis.
 - 2.1.1. The basic principles underlying any basis of charging are set out in the "Ferris Report" (i.e. *Report of Mr. Justice Ferris' Working Party on the Remuneration of Office Holders*, July 1998). There is a clear implication that the rules ought to provide a system for fixing remuneration which is both predictable and transparent.
 - By predictable is meant that there should be a system which enables the office holder to know, with a reasonable degree of certainty, the basis on which he is to be remunerated for a particular job and, correspondingly, enables creditors to know what they are going to see paid out.
 - By transparent is meant that the system ought to enable interested parties to see how a claim for, or award of, remuneration matches up to the regulations.
 - 2.1.2. In most common law jurisdictions, including Hong Kong, charging by office holders is on the basis of hourly rates. This basis has been extensively considered both by Courts, for example, in *Maxwell*, *Peregrine* and *Independent Insurance* and by government working parties, for example, *Ferris*.
 - 2.1.3. While all the judges and working parties who have considered this issue have acknowledged that charging on the basis of hourly rates is not perfect, no better alternative has been found. Recently, *Ferris J.* has said in the *Independent Insurance* case that it is inevitable that the time spent is a major factor and that, in rewarding time spent, the charging rate in the relevant market is crucial.

- 2.1.4. The corollary of basing charges on hourly rates is that there must be transparency and accountability on the part of office holders. We consider that this can be dealt with through information and disclosure requirements as part of the taxation/determination process and by office holders adopting the Draft Guidelines referred to section 7.1 below. There needs to be proportionality in the extent of the information and disclosure requirements and an understanding that time spent by office holders in complying with these requirements is a proper cost of the administration. An important step in the information and disclosure process is the agreement of fee submission formats for the purposes of determination. It is also critical, in the interests of consistency and predictability, that the distinction between costs that must be captured through the hourly rate and costs that are chargeable as disbursements is clear.

3. The Present Position

- 3.1. If a Committee of Inspection ("COI") is appointed, the office holders' remuneration, both quantum and rates, will be fixed by the COI unless they are unable to reach agreement with the liquidators.
- 3.2. In some cases, for specific reasons associated with the liquidation, the office holder may ask the court to agree his fees. This may be because he has been unable to agree his fees with the COI, or for example where provision of detailed information (such as that contained in a fee note) to a COI member may in some way prejudice a potential action against that COI member, or someone with whom it is known the COI member is connected or is in close contact.
- 3.3. Where no COI is appointed, or provisional liquidators are appointed, there exists no alternative process for agreeing the office holder's remuneration other than by applying to the Court. At that time the Court will consider the office holder's claims based on the terms of the order of appointment.
- 3.4. Following the establishment of Panel A in 1996, it became the practice for the order of appointment to contain a provision stating that the office holder's remuneration would be based on the scale of rates agreed between the ORO and the HKSA. The scale rates were calculated as an average of the charge-out rates of the members of the Panel A Scheme, excluding the highest and the lowest rates. Although it was originally intended that there should be an annual review of the fee scale, in fact there has been no change in the scale since 1998.
- 3.5. Recently, following concerns expressed by the judiciary, reference to the scale has sometimes been replaced by a reference to the charge-out rates of the firm whose partners/directors are being appointed as office holder.
- 3.6. In cases where no COI has been appointed, the reference to the HKSA/ORO agreed rates has remained.

4. Test to be applied by the court when assessing remuneration

- 4.1 In her talk to Insolvency Interest Group (IIG) of HKSA on 2nd July 2003 Madam Justice Kwan described the test to be applied by the court in assessing remuneration as follows:

"The test is whether a reasonably prudent man, faced with the same circumstances in relation to his own affairs, would lay out or hazard his own money in doing what the liquidator has done. A liquidator is expected to deploy sound commercial judgment, not to act regardless of expense."

- 4.2 This test is derived from the judgments of Mr. Justice Ferris in *Mirror Newspapers Plc v. Maxwell* and Madam Justice Le Pichon in *Peregrine (No.1)*.

- 4.3 In the forthcoming dialogue with the court regarding rates and other aspects of remuneration, it is likely that the court will regard the "prudent man test" as established by authority and not open to debate. It would be helpful, however, to attempt to ensure that the court understands and acknowledges the context in which the test should be applied, in particular by reference to the following principles:
- 4.3.1 It would be unfair to assess the office holder's judgment with the benefit of hindsight. The assessment should be based upon what the office holder knew (or ought to have known) at the time the judgment was formed.
- 4.3.2 "Prudent" is defined as "careful and sensible". In the context of a liquidation, the court should find the "prudent man test" satisfied wherever there is evidence that the liquidator has given reasonable consideration to the risk/reward analysis related to any cause of action ("careful") and where, looked at objectively without the benefit of hindsight, it was reasonable to place the relevant funds at risk in view of the prospects of enhanced recoveries ("sensible").
- 4.3.3 It would not be in the interests of creditors for the court to interpret the "prudent man test" as a conservative test. It is not. It is a test intended to prevent office holders being paid for reckless pursuits.
- 4.3.4 The additional recoveries, if any, which resulted from the exercise of the office holder's judgment should have limited, if any, relevance when assessing whether the judgment was sound at the time it was exercised.
- 4.3.5 The "prudent man test" is only relevant to time spent on discretionary action and not to non-discretionary steps which must be taken because they are an inevitable consequence of the office holder's appointment (e.g. meetings with creditors, the claims process, accounts etc.)
- 4.4 The court would no doubt be assisted by office holders being able to produce evidence (perhaps in the form of a file note) of the care taken over the risk/award analysis and the good sense of the relevant decision.

5. Guiding Principles

- 5.1 Before considering options relating to office holders' remuneration, it is important to establish certain guiding principles which should be the foundations of any system. Each of these are discussed in more detail below.
- 5.2 Any system of charging by the hour and at standard rates should be fully transparent to protect the interests of all stakeholders. Furthermore, it is essential that the Courts be satisfied with the basis of such a system, as in certain circumstances it has the responsibility of reviewing remuneration claims. We consider that any system of remuneration needs to have the following characteristics:
- Transparency and Accountability
 - Certainty
 - Consistency
 - Agreement of what is Chargeable and Recoverable.

Transparency and Accountability

- 5.3 Reference is made to section 7, and in particular to the Draft Guidelines, which address previous concerns expressed by the judiciary on these two aspects.

Certainty

- 5.4 It is a matter of natural justice, and fairness from a commercial point of view, that an office holder should be certain, at the time of his appointment, of the basis on which his fees will be assessed.
- 5.5 There should be a mechanism in place for agreeing how that rate is to be established.
- 5.6 If these two principles are accepted it will provide certainty for creditors and allow them to take into account the likely costs of the insolvency process when deciding who should be appointed. Moreover, creditors would also gain comfort from a benchmark which has the tacit agreement of both the HKSA and the Court.

Consistency

- 5.7 There should be a consistency of approach between the various parties, that is the Court, TM and the ORO, in assessing/taxing claims for office holders' remuneration. The lack of consistency between, or within, the TM, often leads to inefficiency and injustice. Any lack of consistency inevitably will have an impact on creditors. It will result in additional costs being incurred dealing with queries by the Court. It will also cause delays in agreeing fees, which in turn can result in delays in the payment of dividends.
- 5.8 If it is possible to reach an agreement with the Court on those areas where, at present, there is a difference of approach, office holders will then be able to ensure that future remuneration claims submitted to the court will comply with those guidelines/requirements. At present, the lack of consistency means that it is not possible for office holders to anticipate the approach which will be taken in respect of any particular remuneration claim.

Agreement as to what is chargeable and recoverable

- 5.9 In section 7 below, this paper addresses in more detail certain types of work undertaken by office holders for which time is charged. These are items that are often the subject of differing interpretations as to their recoverability.

6. Options for Rates

- 6.1 The Official Receiver has stated that he no longer wishes to support or promote the rates known as the Panel A rates. We see advantages for creditors, the Court and office holders in replacing that scale, which has worked perfectly well for several years, with a standard set of rates calculated in a scientific manner, backed by the HKSA.
- 6.2 In most other comparative jurisdictions, in particular Australia and the United Kingdom, the majority of liquidations with assets are undertaken by the private sector under the equivalent of the Hong Kong voluntary liquidation procedure. In both of those other jurisdictions, there are relatively few court-supervised liquidations with assets of any significant level.
- 6.3 The position in Hong Kong is diametrically opposite in that the majority of liquidations in which there are assets are Court supervised. It is for this reason that the Court has become involved, to the extent which it has, in discussions on the subject of office holder's remuneration.

6.4 It has been suggested that the provisions of Rule 4.30 of the UK Insolvency Rules may be employed to fix remuneration. A copy of the relevant UK rules is at the Annex. Whilst the option is superficially attractive, the view of the HKSA is that it would in practice prove extremely difficult to implement. Firstly it would not provide any degree of certainty to any of the parties concerned. Secondly, in the absence of a supporting benchmark around which to base the subjective criteria set out in Rule 4.30, it is envisaged that it would be extremely difficult for the Court/TM, in view of its lack of experience in relation to the work undertaken by insolvency practitioners, to apply these criteria.

6.5 Two options are considered to be most practical and achievable:

- industry-wide agreed rates (option 1); or
- agreement to be reached with the Court on a case-by-case basis (Option 2).

6.6 Option 1

6.6.1 The Insolvency Practitioners Committee (IPC) of the HKSA comprises representatives of 14 firms which undertake varying numbers of compulsory liquidation cases. In a majority of those cases, a COI is appointed and the liquidators' charge-out rates have been agreed with those committees.

6.6.2 Those firms will be asked to provide to the HKSA details of the actual rates, including discounts, which they have agreed with COIs on their cases during, say, the previous one to two years. The firms will be asked to separate these into three categories that is, straightforward, more difficult and challenging. Whilst these descriptions are necessarily subjective, we believe that office holders will be able to differentiate between the different types of cases with which they have dealt.

6.6.3 A weighted average will then be calculated, taking into account discounts which have actually been negotiated with COIs.

6.6.4 We believe that this will provide a representative benchmark, being based on the actual rates charged for liquidations rather than the "headline" rates.

6.7 Option 2

6.7.1 In those cases where a COI is not appointed at the meeting of creditors, the scale of fees to be charged by the liquidator should be the subject of a resolution to be passed by the creditors present at the first meeting. If the proposed liquidator and the creditors are unable to reach an agreement, the scale of fees will be agreed by the Court following discussion with the proposed liquidator at the time of his appointment.

6.7.2 The benefit of option 1 is that if it is possible to calculate a fair scale of rates acceptable to the profession, the Court and creditors, it will establish a transparent and accountable system for agreeing the remuneration claims of office holders.

7. The Profession's Approach

7.1 Draft Guidelines on Liquidators' Remuneration ("Draft Guidelines")

7.1.1 In 1999, in response to concerns raised by the judiciary, particularly in the Peregrine case, a number of individual insolvency practitioners produced a series of proposed guidelines to cover the recording and reporting of time spent by office holders on specific assignments. The work of this group was then incorporated into that being undertaken by a working party formed by the

Official Receiver, comprising members of the HKSA, the Law Society and other interested parties.

- 7.1.2 The resulting document sought to create a system of time recording which is both transparent and which creates greater accountability than had previously existed.
- 7.1.3 Copies of this document have been provided to the current Companies Judge and her two predecessors. Whilst this document has not yet been endorsed by the Court, a majority of office holders in Hong Kong have revised their time recording systems to comply as far as possible with the principles set out in the Draft Guidelines.
- 7.1.4 The HKSA is prepared to issue the Draft Guidelines (revised as necessary as a result of this dialogue with the Court and any updating that may be required) with the recommendation to its members that all claims for remuneration submitted to the ORO, COIs or the Court should be submitted on the basis of the Draft Guidelines.

7.2 Standard Formats for Remuneration Claims

- 7.2.1 During the last 12 months, the HKSA has undertaken considerable work in creating a Standard Format for Remuneration Claims ("Standard Format"). This Standard Format was created using the guidelines issued by the TM in Hong Kong and taking into account the guidelines issued by R3, the principal insolvency organisation in the UK.
- 7.2.2 A copy of this document has been submitted to the TM in the context of the HKSA's comments on the Procedural Guides (see paragraph 1.3 above). The HKSA is prepared to issue this document to its members recommending that all claims submitted to the ORO, COIs, the court or the TM should be submitted in this format.
- 7.2.3 We believe that the preparation and submission of remuneration claims in a standard format will greatly enhance transparency and assist creditors and the Court in considering such claims. Furthermore, the level of detail provided in the supporting documents to the claim should further satisfy any concerns regarding accountability and transparency.

Specific issues of recoverability

7.3 Secretarial Time

- 7.3.1 In calculating the time costs of partners and staff, most insolvency firms do not include secretarial costs as overheads, as by the nature of our work this fluctuates widely between cases, and it is thought to be fairer to record actual secretarial time for each case and charge accordingly. Therefore the time costs of the usual fee earners do not include any allowance for secretarial costs.
- 7.3.2 If the Court considers that such time is not recoverable, this will inevitably result in accounting firms revising their budgetary system with a consequential increase in their charge out rates.
- 7.3.3 However, by agreeing to the recovery of directly attributable secretarial time, the cost involved (that is the lowest rate) will more accurately reflect the value of the work (i.e. typing) undertaken. This also reduces the use of higher grade professional staff to do administrative work. For much the same reason it is considered that time spent by junior staff on photocopying documents should also be recoverable.

7.4 Travelling Time

- 7.4.1 Where the basis of charging remuneration is the number of hours spent on a matter, it is necessary to assess the extent to which it is permissible to charge travelling time. It would be helpful to have guidelines which allow reasonable remuneration for travelling time.
- 7.4.2 We believe that it is reasonable to allow office holders to charge for travelling time that is wholly and necessarily spent in any travel necessitated by the matter at hand, except to and from a place where staff are located for a long period of time and excluding their normal travelling time to work.
- 7.4.3 Subject to a maximum of 8 chargeable hours a day, such recovery is justifiable on the basis of the assumption that the office holder would be doing productive work if not prevented from doing so by the relevant travel.

7.5 Costs of preparation of remuneration claims

- 7.5.1 Office holders recognise that creditors and the Court are entitled to be provided with detailed information with which they can properly assess remuneration claims. However, recognition should be given to the fact that provision of such information can often take a significant amount of time.
- 7.5.2 It is therefore reasonable that office holders should be allowed to recover the costs associated with the provision of such information, particularly if its provision is mandated by the court.
- 7.5.3 There is an analogy with solicitors who, if they appoint a law cost draftsman to prepare a bill of costs for taxation, are able to recover such costs. At present, there is a significant burden on office holders to provide detailed information to creditors, COIs, the ORO, and the Court. However, there is no provision for the costs of providing that information to be recovered.
- 7.5.4 In Chapter 11 proceedings in the USA, where there are stringent requirements for the provision of information to the Court in pursuance of office holders remuneration claims, there is also provision for the costs so incurred to be recoverable.

7.6 Internal Meetings

- 7.6.1 At the IIG presentation (see paragraph 4.1 above), Kwan J made the following comments: "Fee earners are professionals and expected to work on their own without the need for internal conferences. Time charged in this respect would only be allowed where it is demonstrated that benefit was indeed derived from each participants area of expertise, or where it can be shown that the conference was really necessary to the efficient management of the administration".
- 7.6.2 In a law firm and accountancy firms there is often a requirement for internal meetings to be held, the costs of which should be recoverable, provided it can be shown that the meetings were necessary to the case in hand.
- 7.6.3 Moreover, it is often the case that certain work will be undertaken by teams of people. Internal meetings are one way in which team members can, as appropriate be brought up to date. It is a standard practice of insolvency practitioners to delegate tasks to the lowest capable cost base. Such delegation requires internal conferences for management, compliance and case efficiency, and thereby saves costs.
- 7.6.4 In an insolvency practice, the main purpose of internal meetings is therefore to:-
- Enable senior staff to monitor progress on assignments, again either at a macro or at a micro level.

- Consider strategy in relation to a particular assignment whether at a macro or micro level.
 - Pass on instructions to more junior members of staff.
- 7.6.5 This is done in order to ensure that the grade of staff undertaking the work is commensurate with keeping the costs to a minimum. Insolvency practices traditionally have a greater range of charge out rates compared, for example, with barristers, who in effect work without support (other than secretarial).
- 7.6.6 The respective lower levels of technical skill and experience of the lower grades of staff when compared with legal firms, and the consequent lower charge-out rates and costs, create an increased requirement for internal discussions to maintain control of assignments, monitor progress and ensure that work is done to the highest possible standard commensurate with costs being kept to a reasonable level.
- 7.6.7 Moreover, the timesheet review process set out in the Draft Guidelines (see section 7.1 above) should serve to ensure that time spent on unnecessary meetings (if any) is not charged to the job.

8. Summary

- 8.1 This paper addresses issues specifically raised by the TM with the ORO. However, separately, the TM has written to the IIG in relation to proposed Procedural Guides and the format in which remuneration claims should be submitted (see paragraph 1.3 above).
- 8.2 The HKSA considers that it would be appropriate to consider these two matters jointly in order that the issues surrounding office holders' remuneration can be brought to an early conclusion.

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