



## **SUMMATIVE (FORMAL) ASSESSMENT: MODULE 9**

### **ETHICS AND PROFESSIONAL PRACTICE**

This is the **summative (formal) assessment** for **Module 9** of this course and is compulsory for all candidates who **selected this module as one of their elective modules**.

**The mark awarded for this assessment will determine your final mark for Module 9.** In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

## **INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT**

**Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.**

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.
2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way. DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.
3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).
4. You must save this document using the following format: **[studentnumber.assessment9]**. An example would be something along the following lines: 202021IFU-314.assessment9. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words “studentnumber” with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked.**
5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words.**
6. The final submission date for this assessment is **31 July 2021**. The assessment submission portal will close at **23:00 (11 pm) GMT on 31 July 2021**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.
7. Prior to being populated with your answers, this assessment consists of **8 pages**.

**ANSWER ALL THE QUESTIONS**

Commented [JL1]: TOTAL: 46 out of 50  
Well done!!

**QUESTION 1 (multiple-choice questions) [10 marks in total]**

Commented [JL2]: 10 out of 10

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

**Question 1.1**

Please choose the **most correct answer** from the options below.

INSOL International's *Ethical Principles for Insolvency Professionals*

- (a) are mandatory and apply to all its members.
- (b) creates a set of rules which all jurisdictions have to incorporate into their insolvency frameworks.
- (c) creates a set of rules by which stakeholders and the public in most jurisdictions would be able to determine whether insolvency practitioners are acting in accordance with ethical principles.
- (d) creates a set of best practice principles to inform and educate insolvency practitioners and stakeholders by providing ethical and professional guidance on issues of importance.**

**Question 1.2**

The "Enlightened Creditor Value" approach to insolvency proposes the following with regard to the protection of competing interests in insolvency proceedings:

- (a) creditors' interests are of paramount importance and as such only these interests should be protected in insolvency.
- (b) The interests of stakeholders should be regarded in the same manner as those of creditors.
- (c) Creditors' interests are of paramount importance, however, the interests of other stakeholders should also be considered where this would be in the creditors' interests.**
- (d) Only the shareholders of the company and the creditors of the company should be protected by the insolvency law (and in that order).

**Question 1.3**

All insolvency professionals are fiduciaries.

- (a) True
- (b) False**

#### Question 1.4

Being truthful and being honest is **not** the same thing.

(a) True

(b) False

#### Question 1.5

Tony has been appointed as a liquidator of Company X. Company X has several major creditors, including ABC Bank. A year prior to the liquidation of the Company, Tony was acting in an advisory capacity for ABC Bank in litigation against Company X where he attempted to advance ABC's position as a creditor.

This situation is an example of a/an \_\_\_\_\_ threat.

(a) self-review

(b) self-interest

(c) advocacy

(d) intimidation

#### Question 1.6

A lack of independence and impartiality due to a prohibited relationship with a stakeholder can always be remedied by disclosing the relevant relationship to the relevant parties and issuing a declaration of independence.

(a) True

(b) False

#### Question 1.7

Julie is a well-known insolvency practitioner and is often sought out for her knowledge and expertise. She currently has ten ongoing insolvency matters (most of them quite complex) and has been feeling somewhat overwhelmed. Due to her impressive *curriculum vitae* she is contacted by a very large designer company in distress inquiring whether she would be able to take an appointment as an administrator. Julie should:

(a) Accept the appointment as it will boost her career even further.

(b) Accept the appointment as she can get one of her junior associates to take over all her other cases.

(c) Accept the appointment because as a professional she will have the ability to give all of the cases she is involved in some attention, although some of them will now only be overseen by her.

(d) Refuse the appointment as she will not be able to give all of the cases she is involved in the requisite level of attention.

### Question 1.8

Johnson has been appointed as a new associate at the firm where he is employed. In his new role he has to meet certain targets in relation to the fees he earns for taking appointments. Johnson is currently appointed as a liquidator for a small company. He realises that he will not meet the firm's target for fees. The most ethical thing for Johnson to do would be to:

- (a) Call a creditors' meeting requesting an adjustment to his agreed fees due to unforeseen circumstances.
- (b) Ask his administrative assistant to invoice the estate for the use of the firm's conference venue for meetings held there at a 50% increased fee.
- (c) Carry out his duties in a timely fashion and complete the appointment efficiently and without undue delay, only invoicing for work properly performed.
- (d) Ask his administrative assistant to double check all the calculations in the case file and then bill the hours as part of his invoice.

### Question 1.9

Please choose the **most correct answer** from the options below.

An insolvency practitioner using a fixed fee calculation method for determining the amount of remuneration owed to him, will receive a fair amount of remuneration.

- (a) This statement is true since jurisdictions always allow for an adjustment of fees where it is necessary.
- (b) This statement is false since the practitioner might have carried out more work and invested more resources than is reflected in the fee.
- (c) This statement is false since the practitioner will always receive more remuneration than what is reflected in the work carried out.
- (d) This statement is false since the only way to receive a fair amount of remuneration is to calculate the remuneration on an hourly rate.

### Question 1.10

Please choose the **most correct answer** from the options below.

Fathima has just completed Module 9 of INSOL International's Foundation Certificate. She works as a junior insolvency practitioner at a large firm. Her firm is contemplating the acquisition of a new information technology system to help ease the administrative burdens of the practitioners at the firm. This new system will digitise all of the documents in relation to insolvency appointments. All the practitioners and administrative personnel employed by the firm will have access to these files as long as they have access to an internet connection. Fathima should advise someone in the office to implement procedures and policies on \_\_\_\_\_ in relation to this proposed new system.

- (a) quality Control
- (b) risk Management

(c) compliance management

(d) fidelity insurance

**QUESTION 2 (direct questions) [10 marks]**

Commented [JL3]: 10 out of 10

**Question 2.1 [maximum 4 marks]**

What are the main fiduciary and other duties usually associated with insolvency professionals?

The main fiduciary duties usually associated with insolvency professionals are as follows:

1. the duty to act in good faith (which implies honesty and fair dealing);
2. the duty to act in the best interest of the beneficiary/beneficiaries of the fiduciary duties; and
3. the duty to act in an independent and impartial manner, when exercising powers of office, which includes the duty to avoid conflicts of interest.

In addition, although not generally regarded as a fiduciary duty, the duty to act with care, skill and diligence is usually associated with insolvency professionals.

Commented [JL4]: 4

**Question 2.2 [maximum 4 marks]**

Briefly explain the two-pronged nature of the duty to act with independence and impartiality.

The two-pronged nature of the duty to act with independence and impartiality is explained in Principle 2 of the INSOL International Ethical Principles for Insolvency Professionals<sup>1</sup>: insolvency professionals have a duty to act with independence and impartiality (1) as a matter of fact and (2) from the perspective of an informed observer. An insolvency professional will be considered to be acting with independence and impartiality:

1. as a matter of fact, where factually there are no influences affecting and compromising the insolvency professional's judgment; and
2. from the perspective of an informed observer, where the insolvency professional acts in such a way that would not be perceived by an informed observer as being a compromise of the independence and impartiality of that insolvency professional.

Principle 2 goes on to describe the duty to act with independence and impartiality in the exercise of an insolvency professional's powers and duties, with the "key tent underlying the principle of independence" as "ensuring that a [insolvency professional's] conduct is, and is seen to be, not unfairly or improperly biased towards any party" (which includes insolvency professionals themselves and their associates). Insolvency professionals should avoid the following (each of which are set out in Principle 2):

- (a) circumstances likely to result in a conflict of interest (and insolvency professionals should disclose a conflict of interest, a lack of independence or circumstances that may lead to a conflict of interest<sup>2</sup>);

<sup>1</sup> Available online at: [https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL\\_64I2neSe44VEULhbTQXZ.pdf](https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL_64I2neSe44VEULhbTQXZ.pdf)

<sup>2</sup> UNCITRAL Legislative Guide on Insolvency Law, 2004, available online at: [https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722\\_ebook.pdf](https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf), p188, para 116

(b) where appointed over an estate, acquisition or removal of any assets or cash from the estate except as prescribed or as properly authorised remuneration; and

(c) unjust enrichment for example by receiving secret kick-backs or commissions.

Commented [JL5]: 4

### Question 2.3 [maximum 2 marks]

What is the preferred method of calculation of insolvency practitioner remuneration? Name one ethical issue in relation to this method of calculation.

The preferred method of calculation of an insolvency practitioner's remuneration is by time-based remuneration, where the rate of calculation for remuneration is based on one of the following: the insolvency practitioner's hourly or daily rate; the statutory rate; or the rate prescribed by the professional organisation to which the practitioner belongs. Principle 5 of the INSOL International Ethical Principles for Insolvency Professionals states that insolvency practitioners using this method are only to be remunerated for "time properly spent on attending to the case"<sup>3</sup>.

One ethical issue relating to this method has been identified by UNCITRAL in its Legislative Guide on Insolvency Law as follows: "a time-based system may also operate in some cases as an incentive to maximize the time spent on administration without necessarily achieving a proportional return of value to the estate"<sup>4</sup>. This means there is a financial incentive for the insolvency professional to spend a larger amount of time on an administration than they might normally spend, without actually achieving the contemplated goal, which clearly is a significant ethical issue, especially considering that the insolvency professional's fees are normally paid from the debtor's estate.

Commented [JL6]: 2

### QUESTION 3 (essay-type questions) [15 marks in total]

Commented [JL7]: 11 out of 15

#### Question 3.1 [maximum 8 marks]

Which elements of insolvency proceedings are especially prone to create or give rise to threats to independence and impartiality? Please elaborate.

The elements of insolvency proceedings, which are especially prone to create or give rise to threats to independence and impartiality of an insolvency professional, are as follows:

- the connections and relationships of the insolvency professional, the insolvency professional's close or immediate family members and the insolvency professional's firm, with creditors, shareholders, directors and potential purchasers of the insolvent debtor company as well as other similar potential conflicts of interest;
- an insolvency professional and its firm's previous appointments and involvement in respect of any of the creditors and shareholders of the insolvent debtor company, and the debtor company itself;
- an insolvency professional and its firm's previous appointments, in particular for clients involved in disputes against any of the creditors or shareholders of the debtor company or the debtor company itself;

<sup>3</sup> INSOL International Ethical Principles for Insolvency Professionals, October 2018, available online at: [https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL\\_6412neSe44VEULhbTQXZ.pdf](https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL_6412neSe44VEULhbTQXZ.pdf), p6

<sup>4</sup> UNCITRAL Legislative Guide on Insolvency Law, 2004, available online at: [https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722\\_ebook.pdf](https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf), p181, para 54

- the intimidation tactics and threats of others against the insolvency professional and members of its firm; and
- an insolvency professional's remuneration and how this is calculated.

These key elements give rise to the following five threats to independence and impartiality, which are identified in Principle 2 of the INSOL International Ethical Principles for Insolvency Professionals:

- a) self-interest;
- b) self-review;
- c) advocacy;
- d) familiarity; and
- e) intimidation.

Below I will describe each of these threats and explain how the previously identified elements of insolvency proceedings are especially prone to create or give rise to these threats to independence and impartiality.

A **self-interest** threat arises in a situation in which an insolvency professional has, or is perceived to have, a direct interest in obtaining a particular outcome<sup>5</sup>, which then affects the insolvency professional's ability to act with independence and impartiality; for example<sup>6</sup>:

- where the insolvency professional, a close family member of the insolvency professional, someone within the debtor company or someone with, is also creditor or shareholder of the insolvent estate, which may result in the insolvency professional's judgment being influenced into pursuing a certain outcome;
- concern with regards the possibility of damaging a business relationship or future employment, where the insolvency professional has business relationships with the debtor company or certain creditors; and
- where the insolvency professional is appointed in sequential insolvency appointments in relation to the same debtor company for example, as a rescue practitioner and then as a liquidator, the insolvency professional may have an interest in not rescuing the company as he knows he will be appointed as the liquidator and then be remunerated twice by the same company. This self-interest threat in respect of remuneration can also apply where the insolvency professional's remuneration is on a time basis and so there is a financial incentive for the insolvency professional to spend a larger amount of time on an administration/liquidation than they might normally spend, without actually achieving the contemplated goal.

A **self-review** threat arises where actions taken by an insolvency professional, its firm or a close associate of the insolvency professional are perceived to be subject to review only by the insolvency professional<sup>7</sup>, which then affects the insolvency professional's ability to act with independence and impartiality; for example<sup>8</sup>, where the insolvency professional's firm carried out the disposal of certain assets of the insolvent estate prior to insolvency or where they were employed/seconded to the debtor company to work in some other way prior to insolvency, which may result in the insolvency professional not being able to properly, independently and impartially evaluate any previous decision-making in relation to the company leading to

<sup>5</sup> INSOL International Ethical Principles for Insolvency Professionals, October 2018, available online at:

[https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL\\_64I2neSe44VEULhbTQXZ.pdf](https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL_64I2neSe44VEULhbTQXZ.pdf), p10

<sup>6</sup> Scenarios identified as self-interest threats in FN 4, p10 and by the Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p12 para 2114.1 A5(a)

<sup>7</sup> Ibid FN3, p11

<sup>8</sup> Scenarios identified as self-review threats in FN 4, p11 and by the Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p12 para 2114.1 A5(b)



suspicious that the work had been in some way improper, and there are suspicions that the disposal (or other work) is in some way improper.

An **advocacy** threat arises where an insolvency professional promotes a position or opinion to the point that subsequent objectivity may be compromised<sup>9</sup>; for example the following circumstances<sup>10</sup>, which lead to the opinion by other stakeholders that the impartiality and independence of the insolvency practitioner is in question:

- the insolvency professional previously acted on behalf of a creditor to advance such creditor's position; and
- the insolvency professional previously acted as an advocate for a client of its firm in a dispute with the debtor company.

A **familiarity** threat arises where an insolvency professional's relationship to a stakeholder is perceived to impair such insolvency professional's impartiality and objectivity<sup>11</sup>; for example the following circumstances<sup>12</sup>, where the insolvency professional may be, or be perceived to be, too sympathetic or antagonistic to the interests of other stakeholders or the debtor company itself:

- the insolvency professional is a close relative of a significant creditor or shareholder or of a director of the debtor company; and
- the insolvency professional, an individual within its firm, or a close or immediate family member of the insolvency professional having a close relationship with a potential purchaser of the insolvent entity's assets and/or business or any individual having a financial interest in the potential purchaser.

An **intimidation** threat arises where an insolvency professional is, or may be, threatened or pressured<sup>13</sup>; for example<sup>14</sup>, where the insolvency professional or an individual within its firm is being threatened with physical harm, dismissal or replacement, litigation, a compliant or adverse publicity, leading to the ability of the insolvency professional to act with impartiality and independence being **questioned**.

### Question 3.2 [maximum 7 marks]

As insolvency appointments often involve complex legal issues, it is common practice for insolvency practitioners to rely on the advice and services of legal professionals. What ethical considerations should be borne in mind, especially regarding the fees of these legal professionals?

There are various ethical considerations for an insolvency practitioner to bear in mind when intending to rely on the advice and services of legal professionals. Helpfully, the following guidelines included in the Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales (the "**ICAEW Guidelines**"), identify the key ethical considerations for an insolvency practitioner to bear in mind when appointing legal professionals:

<sup>9</sup> Ibid FN3, p9

<sup>10</sup> Scenarios identified as advocacy threats in FN 4, p9 and by the Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p12 para 2114.1 A5(c)

<sup>11</sup> Ibid FN3, p9

<sup>12</sup> Scenarios identified as familiarity threats in FN 4, p9-10 and by the Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p12 para 2114.1 A5(d)

<sup>13</sup> Ibid FN3, p10

<sup>14</sup> Scenarios identified as intimidation threats in FN 4, p10 and by the Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p12 para 2114.1 A5(e)

**Commented [JL8]:** This question required you to identify elements of the insolvency PROCESS that might cause issues in relation to independence and impartiality. See page 16 of the GT for this discussion. It seems that you have misread or misunderstood the question. Your discussion is an accurate explanation of issues or rather threats to independence and are not elements of the insolvency process although you do refer to some of the elements of the process. However, the question was not answered in full. I have awarded discretionary marks.

4

1. the insolvency practitioner should evaluate whether such advice or work of legal professionals is warranted<sup>15</sup>;
2. any advice or work contracted should reflect best value and service for the work undertaken<sup>16</sup> and the insolvency professional should consider the following factors, when evaluating if the work is best value and service<sup>17</sup>:
  - a. cost of the service;
  - b. expertise and experience of the legal professionals;
  - c. that the legal professional appointed holds appropriate regulatory authorisations; and
  - d. the professional and ethical standards applicable to legal professionals;
3. assess whether any threats to the fundamental duties of the insolvency professional may arise by virtue of the appointment of the legal professional, for example, familiarity and self-interest threats (explained in the response to Question 3.1 above) to the insolvency professional's duty to act with independence and impartiality, by virtue of the legal professional being a party with whom the insolvency practitioner, its firm or an individual within its firm, has or business or personal relationship (which might include an immediate family member, business party or any company or business in which there are common shareholdings with the insolvency professional's firm)<sup>18</sup>;
4. assess whether conflicts of interest may arise as a result of the appointment of the legal professional<sup>19</sup>;
5. review arrangements periodically to ensure that best value and service continue to be obtained in relation to each insolvency appointment<sup>20</sup>; and
6. document the reasons for choosing that particular legal services provider<sup>21</sup> and be cognisant of any duplication of work between the appointed legal professionals and the insolvency practitioner's firm.

A further ethical consideration when appointing legal professionals was highlighted by Steven Chong J in *Kao Chai-Chau Linda v Fong Wai Lyn Carolyn* [2015] SGHC 260: an insolvency professional must always consider potential duplication of work between himself and the legal professional<sup>22</sup>. The consideration ties to the fees of the legal professionals and the insolvency practitioner should keep in mind how the fees of the legal professionals are to be paid: where the costs of the legal professionals' fees are being claimed as part of the insolvency practitioner's disbursements, the onus will lie on the insolvency practitioner to consider whether the legal professional's bill has been reasonably incurred; and where the legal professionals' fees are being separately billed to the debtor company, the onus will lie on the insolvency practitioner to justify his involvement in matters on which the legal professional was instructed and the work may be shown as anterior to and distinct from the work the legal professional was instructed on<sup>23</sup>. Following the ICAEW Guidelines prior to and during the legal professional's appointment, will undoubtedly aid the insolvency practitioner with this justification process.

It would also be prudent when appointing legal professionals for an insolvency professional to bear in mind Steven Chong J's advice in *Kao Chai-Chau Linda v Fong Wai Lyn Carolyn* of securing the agreement of the relevant stakeholders on the proper division of work between the insolvency professional and any legal professional appointed, at the time of the insolvency

<sup>15</sup> Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p33 para 2320.3

<sup>16</sup> Ibid, p33 para 2320.4

<sup>17</sup> Ibid, p33 para 2320.4A

<sup>18</sup> Ibid, p33 para R2320.6 A1-A2

<sup>19</sup> Ibid, p33 para R2320.6 A4

<sup>20</sup> Ibid, p33 para R2320.5

<sup>21</sup> Ibid, p33 para R2320.6

<sup>22</sup> *Kao Chai-Chau Linda v Fong Wai Lyn Carolyn* [2015] SGHC 260, [56]

<sup>23</sup> Ibid, [57-58]

professional's appointment to avoid work-duplication and over-servicing arguments arising at the time of remuneration<sup>24</sup>.

Commented [JL9]: A very good answer.  
7

**QUESTION 4 (fact-based application-type question) [15 marks in total]**

Commented [JL10]: 15 out of 15

WeBuild Ltd is a private company registered in Eurafriolia. The company specialises in construction and property development and is well known in the area where it conducts business. Mr B Inlaw, Dr I Dontcare and Mrs I Relevant are the directors of the company. The company has ten shareholders, with Mr B Inlaw and Dr I Dontcare also holding shares in the company.

The company traded profitably for the last 10 years but recently started to experience financial difficulties. One of the main reasons for the decline is the fact that several of the company's employees have instituted a class action claim against WeBuild for workplace related injuries due to faulty machinery. This also resulted in bad publicity that led to a decline in contracts. The directors of the company were made aware of the issues relating to the machinery but chose not to take any action to remedy the situation. When the company's financial position started to decline the directors continued to trade as if nothing was amiss and even made several large payments to themselves by way of performance bonuses. When they received a letter of demand from the company's major secured creditor, ABC Bank, the directors decided to call a shareholders' meeting to discuss the company's options.

Present at this meeting were the shareholders, the directors and Mr Relation, a lawyer, to provide them with information and advice in relation to their options. Some of the shareholders recognised Mr Relation as Mr B Inlaw's brother-in-law and godfather to his daughter. During the meeting, Mr Relation suggests that the company enter into a voluntary administration procedure. Mr B Inlaw suggests that the company appoint Mr Relation as administrator. He accepts the appointment, ensuring that he discloses his relationship with Mr B Inlaw and says that he will declare that he believes that he will still be able to act with the required independence and impartiality.

After the meeting adjourns, Mr B Inlaw requests the other directors and Mr Relation to stay behind for a brief "planning" meeting. During this subsequent meeting the directors inform Mr Relation that they are concerned about their personal liability for breach of duty. Moreover, they are worried that they might land in hot water due to their decision to continue trading when the company was clearly in dire financial straits. Mr Relation assures them that his focus will not be on them but on trying to rescue the company.

In the weeks that follow, Mr Relation conducts a superficial investigation into the affairs of the company and the circumstances leading to the financial difficulty of the company. He relies on detailed reports drafted by Mr B Inlaw regarding the company's business and drafts a strategic plan for recovery based on his investigation and the reports he received.

At a meeting of creditors to consider the plan, Mr Relation states that he has found no evidence of any wrongdoing or maladministration by the company's directors. Mrs Keeneye, a lawyer attending the meeting on behalf of ABC Bank, the major secured creditor, recognises Mr Relation from a television interview where Mr Relation expressed the opinion that banks should be more accommodating in restructuring proceedings and that he thinks that the interests of lower ranking creditors should sometimes outweigh "big money" (referring to financial institutions). She immediately feels uncomfortable with his appointment as administrator.

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<sup>24</sup> Ibid, [60]

Several months later the administration fails due to a "lack of funding" to finance the rescue. The administration is subsequently converted to liquidation proceedings and Mr Relation is appointed as the liquidator.

### **INSTRUCTIONS**

There are at least **THREE** major ethical issues in this factual scenario.

**Please identify these ethical issues and explain in detail why they are in fact ethical issues. Your answer should include reference to the ethical principles and the commentary thereon. Where appropriate and suitable, you should also endeavour to elaborate on possible remedies or safeguarding mechanisms to minimise or remove the ethical threats.**

**You may also make use of case law and secondary sources to substantiate your answer.**

In its Legislative Guide on Insolvency Law, UNCITRAL notes that an insolvency representative should possess integrity, impartiality, independence and good management skills<sup>25</sup>. Throughout this scenario, the afore-mentioned skills and actions of Mr Relation have been called into question and major ethical issues have arisen.

Each of the ethical issues arising in this factual scenario is described and evaluated below, and suggested specific safeguards, appropriate to each issue, have been stated. When preparing this response, I have assumed that the proceedings are taking place in Eurafriolia, Eurafriolia has no specific code of conduct for insolvency professionals and Mr Relation is subject to the fiduciary duties and ethical principles and guidance, which insolvency professionals are generally accepted to be subject to.

This response has been confined to the ethical issues relating to Mr Relation's appointment. I note there are also clearly legal (albeit, depending on the law of Eurafriolia) and ethical issues with regards to the directors' behaviour and the potential breach of their duties to WeBuild Ltd (the "**Company**") and its stakeholders: the directors continued to trade whilst the company was in dire financial straits, which may constitute wrongful trading, and awarded themselves large bonuses at this time. They also allegedly put their employees at risk of harm due to faulty machinery.

As mentioned above, specific safeguards are noted when discussing each of the issues below. In general with respect to each ethical issue, when an insolvency professional identifies a threat to compliance with any of the fundamental principles, they must evaluate whether such a threat is at an acceptable level<sup>26</sup>. The Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales (the "**ICAEW Guidelines**") identify the following general safeguards, which may be put in place to assist in evaluating the level of these threats<sup>27</sup>:

- (a) corporate governance requirements;
- (b) educational, training and experience requirements for the profession;
- (c) professional standards;

<sup>25</sup> UNCITRAL Legislative Guide on Insolvency Law, 2004, available online at:

[https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722\\_ebook.pdf](https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf), p175, para 41

<sup>26</sup> Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p13 para R2115.1

<sup>27</sup> Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p13 para R2115.2 A2

- (d) effective complaint systems which enable the insolvency practitioner and the general public to draw attention to unethical behaviour;
- (e) an explicitly stated duty to report breaches of ethics requirements;
- (f) professional or regulatory monitoring and disciplinary procedures; and
- (g) external review by a legally empowered third party of the reports, returns, communications or information produced by the insolvency practitioner.

Each of these should be considered as safeguards to the threats identified below.

In general, where any threat is at an unacceptable level, Mr Relation should eliminate the circumstances creating the threats, apply safeguards to reduce the threat to an acceptable level or decline/end the insolvency appointment<sup>28</sup>. To form a conclusion about which action to take, Mr Relation should review any significant judgments made or conclusions reached and make an assessment from the perspective of a reasonable and informed third party<sup>29</sup>.

#### (1) Relationship between Mr Relation and Mr B InLaw

Mr B Inlaw is a director and a shareholder of the Company and Mr Relation is Mr B Inlaw's brother-in-law as well as godfather to Mr B Inlaw's daughter. The relationships create an ethical issue with Mr Relation's appointment as the insolvency professional, in respect of the Company, as further described below.

Principle 2 of the INSOL International Ethical Principles for Insolvency Professionals (the "INSOL Ethical Principles") requires insolvency professionals to exhibit the highest levels of objectivity, independence and impartiality in the exercise of their powers and duties and avoid circumstances likely to result in a conflict of interest. The commentary to Principle 2 of INSOL Ethical Principles states that an insolvency professional should not accept an appointment if his relationship with the directors or any stakeholders would give rise to a possible or perceived lack of independence, noting that lack of independence cannot necessarily be cured by disclosure<sup>30</sup>. Further, the ICAEW Guidelines identify the scenarios of an insolvency practitioner having a close business relationship with a party to the transaction and concern about the possibility of damaging a business relationship as creating a self-interest threat to the principle of independence and objectivity and an insolvency practitioner having a close relationship with a director in the insolvent entity<sup>31</sup> as creating a familiarity threat to the principle of independence and objectivity.

Through Mr Relation's close business relationship with the Company, as its lawyer, a self-interest threat arises, and through Mr Relation's close personal relationship with Mr B Inlaw, a familiarity threat arises. The effect of these threats can clearly be seen through the following actions of Mr Relation:

- (a) Mr Relation assured the directors that he would not be investigating their personal liability and actions during the administration. This is clearly not in line with the scope of his appointment as administrator, which would include investigation into antecedent transactions.

<sup>28</sup> Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p14 para R2116.1

<sup>29</sup> Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p14 para R2116.2

<sup>30</sup> INSOL International Ethical Principles for Insolvency Professionals, October 2018, available online at: [https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL\\_64I2neSe44VEULhbTQXZ.pdf](https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL_64I2neSe44VEULhbTQXZ.pdf), p3

<sup>31</sup> Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p12 para 2114.1 A5(d)(i)

- (b) Mr Relation only conducted a superficial investigation into the Company, relying solely on Mr B-Inlaw's reports in respect of the Company to form a recovery plan. However, he attended the pre-administration meeting, where the directors themselves had raised concerns of wrongdoing and therefore would have been aware of the possibility (at the very least) of wrongdoings of the directors (e.g. wrongful trading and awarding themselves large bonuses when the Company was in financial difficulty), which should have warranted a thorough investigation of the Company and the actions of the directors, if acting in the best interests of the beneficiaries.
- (c) At the creditors' meeting stating that he had found no evidence of any wrongdoing or maladministration by the Company, without having carried out a thorough objective investigation.

These actions also suggest Mr Relation had not complied with Principles 1 and 4 of the INSOL Ethical Principles, to act with integrity and be straightforward, honest and truthful and to act with professional behaviour and communicate accurately and honestly with stakeholders<sup>32</sup>. The directors' actions prior to insolvency, in particular continuing trading when the Company was in financial difficulty and awarding themselves large bonuses, clearly would have had a large impact on the distribution to creditors and, therefore, it was crucial that Mr Relation evaluated these actions and these were included as part of the report.

The INSOL Ethical Principles state that disclosure of these relationships cannot necessarily cure a lack of independence. This statement is also supported by the case of *Commonwealth Bank of Australia v Irving* [1996] 65 FCR 291, where the prior disclosure of the insolvency professional's relationship with the director of the debtor company did not impact the Australian court holding that substantial involvement with a company prior to administration will disqualify the insolvency professional from appointment as administrator. Mr Relation's disclosure and statement of independence and impartiality therefore does not necessarily cure the ethical issues created by his relationships and his substantial involvement with the Company's director prior to the appointment – in short, the appointment should not have been accepted. However, given that the appointment was accepted Mr Relation could have done the following, to safeguard the beneficiaries from, and minimise the effects of, this ethical issue:

- (a) Request independent reports on the Company from Dr I Dontcare, Mrs I Relevant and other shareholders of the Company.
- (b) Interview each of the directors on their conduct with respect to the Company leading up to the administration and record the interview.
- (c) Investigate all antecedent transactions of the Company.
- (d) Assign another qualified personnel from Mr Relation's Company to assist with the review of reports produced by Mr B Inlaw and to communicate with Mr B Inlaw.
- (e) Thoroughly document his communications with the Company.
- (f) Do not discuss the administration on an informal basis with Mr B Inlaw (or other family members), except in the proper course of business of the administration.
- (g) Request full disclosure of the Company's documents and servers so that the Mr Relation's firm could conduct a complete review of the available information
- (h) Contact any of the Company's other advisors (for example, corporate secretary and accountant) for information.
- (i) Appoint a legally empowered third party to conduct an external review of the reports, returns, communications and information produced by Mr Relation.

## (2) Prior Appointment of Mr Relation as the Company's Lawyer

<sup>32</sup> INSOL International Ethical Principles for Insolvency Professionals, October 2018, available online at: [https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL\\_6412neSe44VEULhbTQXZ.pdf](https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL_6412neSe44VEULhbTQXZ.pdf), pp2 and 5

The prior appointment of Mr Relation as the Company's lawyer is an ethical issue as it creates both a self-review threat and advocacy threat to Mr Relation's independence and impartiality and his subsequent compliance with Principle 2 of the INSOL Ethical Principles.

The ICAEW Guidelines identify an insolvency professional having previously carried out professional work as a circumstance which might create a self-review threat<sup>33</sup> and an insolvency professional having previously acted in an advisory capacity to an entity prior to its insolvency as a circumstance which might create an advocacy threat<sup>34</sup>. The self-review threat may arise here as Mr Relation's work for, and remuneration from, the Company in his capacity as the Company's lawyer will only be subject to his review and scrutiny in his capacity as an insolvency professional and arguably he is unable to act impartially and objectively when reviewing his own work quality and scrutinising his own remuneration. The advocacy threat may arise here as in his capacity as the Company's lawyer, Mr Relation was advising the Company, promoting the Company's position and acting in the best interests of the Company (i.e. his client); whereas in his capacity as an insolvency professional, he will be aiming to achieve the objectives of the administration and acting in the best interests of the estate and its stakeholders – these different roles call into question whether he can act objectively in his role as an insolvency professional.

In *Re Korda, Ten Network Holdings Ltd (Admn Apptd) (Recs and Mgrs Apptd)* [2017] FCA 914 (“*Re Korda*”), the administrators' firm had been involved in the review of the debtor's financials prior to the appointment and the Court concurred with the Australian Securities Investments Commission that “significant, long-term and consequently remunerative work” undertaken for the purposes of preparing for a prospective administration should not itself cause a reasonable apprehension of bias<sup>35</sup> and exclude the insolvency practitioner from subsequently taking a formal appointment. It is unclear from the facts, whether Mr Relation was previously the Company's lawyer prior to the shareholders' meeting and if Mr Relation has performed a significant amount of work for the Company as its legal advisor. If Mr Relation's work as legal advisor was simply as stated in the facts and was purely attending the shareholders' meeting in an objective capacity to present options to the Company for its rescue, then it seems, when applying *Re Korda*, the ethical issue created by Mr Relation's previous appointment as legal advisor may not in itself be a reasonable apprehension of bias and may be resolved if appropriate safeguards are in place which avoid the existence or appearance of this sort of conflict<sup>36</sup>.

Appropriate safeguards might include Mr Relation having carried out the following actions<sup>37</sup>:

- (a) making it clear to the board of directors and executives that he was the person who might become the actual administrator if other measures to fix the company's finances do not succeed;
- (b) ensuring that his retainer as legal advisor was clearly defined; and
- (c) ensuring from the outset that he kept a sufficient record of the nature of the tasks performed.

### (3) Subsequent Appointment of Mr Relation as Liquidator

<sup>33</sup> Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p12 para 2114.1 A5(b)

<sup>34</sup> Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p12 para 2114.1 A5(c)

<sup>35</sup> *Re Korda*, [62-63]

<sup>36</sup> *Re Korda*, [35]

<sup>37</sup> *Re Korda*, [36-37]

The subsequent appointment of Mr Relation as liquidator also creates an ethical issue. In some jurisdictions, for example, South Africa, a subsequent appointment of an insolvency practitioner in relation to the same debtor is prohibited by statute, and so, we would first need to ascertain whether a subsequent appointment of an insolvency practitioner as liquidator is allowed in Eurafriicia.

Once the above-noted legal issue is resolved, the key ethical issue then becomes the self-interest threat to Mr Relation's fiduciary duty to exercise his powers as an insolvency practitioner in an independent and impartial manner, when acting as liquidator<sup>38</sup>. The self-interest threat arises as Mr Relation has a financial interest, when acting as administrator, in not rescuing the company as he knows that if the administration is later converted into liquidation proceedings, he will be appointed as the liquidator and then be remunerated twice by the Company for his work both as administrator and liquidator. The ICAEW Guidelines also identify the sequential insolvency appointments of an insolvency practitioner in relation to the same debtor company as giving rise to a self-review threat to the independence and impartiality of the insolvency practitioner<sup>39</sup> due to Mr Relation, in his capacity as liquidator, having to review his actions as administrator, which he may not be able to review objectively.

To safeguard this issue, Mr Relation should appoint a reviewer from his firm, who is appropriately qualified and was not involved in the administration of the Company or consider appointing another insolvency practitioner to perform the role of liquidator.

#### (4) Mr Relation's television interview

Mr Relation has a fiduciary duty to act in the best interest of the beneficiary of the fiduciary duties and to exercise the powers of the office in an independent and impartial manner (Principle 2 of the INSOL Ethical Principles). Mr Relation should act with integrity and avoid bringing the profession into disrepute, when promoting himself or his firm or competing for work (Principle 4 of the INSOL Ethical Principles). By stating in a television interview that his opinion is that the interests of lower ranking creditors should sometimes outweigh "big money", he is not acting in an impartial manner (even though, he is presumably speaking on general terms rather than in respect of specific insolvency proceedings) and is arguably bringing disrepute to the industry by showing a preference for lower ranking creditors over financial institutions. The fact that Mrs Keeneye is aware of the interview and feels uncomfortable by the appointment of Mr Relation as the Company's insolvency practitioner indicates that this is perceived by third parties to be a threat to Mr Relation's professional conduct and impartiality.

To safeguard this risk, the interview should be disclosed by Mr Relation to the Company and its stakeholders and a declaration of independence issued. In addition, Mr Relation's recovery plan and evidence used to formulate it, could be reviewed by a legally empowered external third party, as noted above.

**\* End of Assessment \***

<sup>38</sup> INSOL International Ethical Principles for Insolvency Professionals, October 2018, available online at: [https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL\\_6412neSe44VEULhbTQXZ.pdf](https://cdn.website-editor.net/c1bf33c37353462b802fc473aaf1a7f1/files/uploaded/Ethics%2520Principles%2520for%2520Insolvency%2520Practitioners%2520-%2520from%2520INSOL_6412neSe44VEULhbTQXZ.pdf), p3

<sup>39</sup> Insolvency Code of Ethics of the Institute of Chartered Accountants of England and Wales, available at: <https://www.icaew.com/-/media/corporate/files/technical/ethics/insolvency-code-of-ethics.ashx?la=en>, p12 para 2114.1 A5(b)

**Commented [JL11]:** An excellent answer with good application of the principles to the facts.  
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