Liquidators and Close Relationships

Re Walton Construction Pty Ltd (in liq); ASIC v Franklin [2014] FCA 68

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Summary

The Federal Court considered whether the particular circumstances of a referral to an insolvency practitioner gave rise to a conflict of interest and whether there were defects in the disclosure of the relationship between the Liquidators and the referrer. The Court held that there was no conflict and the disclosure in the DIRRI was appropriate.

The Facts

The Mawson Group acted as advisors to Walton Construction Pty Ltd (in Liq) and Walton Construction (QLD) Pty Ltd (in Liq) (the **Walton Companies**). Mawson Group was involved in restructuring within the Walton Companies prior to their entering administration. The Walton Companies later entered into liquidation.

The other defendants (the 'Liquidators') were the liquidators of the Walton Companies, having been initially appointed administrators following a referral to them by the Mawson Group.

On a number of prior occasions the Mawson Group had referred to the Liquidators other opportunities for insolvency appointment.

The restructuring had involved the Walton Companies assigning debts and transferring assets to companies associated with the Mawson Group.

The Administrators provided creditors with a Declaration of Relevant Relationships (DIRRI) as follows:

> *"The [companies were] referred by … the Mawson Group, who refers us insolvency type matters from time to time. Referrals from solicitors, business advisors and accountants are common place and do not impact on our independence in carrying out our function as Administrators……"*

ASIC's Claim

ASIC applied to the Court pursuant to section 503 of the Corporations Act (the **Act**) seeking an order that the Liquidators be removed on the grounds they lacked impartiality and independence.

ASIC argued their relationship with the Mawson Group gave rise to a reasonable apprehension the Liquidators may not be impartial, noting particularly the number of previous referrals from the Mawson Group and the need to investigate the Mawson Group in relation to the pre-administration transactions in this case.

ASIC sought a declaration from the Court the Liquidators had breached s 436DA of the Act because their DIRRI was deficient in that the Liquidators had failed to disclose that they would need to investigate the Mawson Group's involvement in the pre-administration transactions.

Relevant Legislation

Section 503 of the Act provides that the Court may, on cause, remove a liquidator.

Section 436DA provides that an administrator must make the prescribed declaration of relevant relationships and indemnities granted to him or her. The DIRRI should also state, if there are any such relationships, why the administrator believes that they do not give rise to a conflict of interest or duty.

Outcome

Her Honour Justice Davies in the Federal Court refused both applications. In doing so, she referred to the test for determining whether a liquidator should be disqualified for apprehended lack of independence and impartiality. That test requires considering whether a hypothetical, fair-minded observer would have such an apprehension.

In applying the test her Honour considered that such a person would understand that:

- referral relationships are a common business practice;
- liquidators have statutory duties and responsibilities that they must discharge;
- liquidators have a responsibility for investigating voidable transactions;
- liquidators are commonly referred voluntary administrations and other insolvency work by solicitors, accountants and business advisors;
- liquidators have a duty to remain impartial and independent; and
- if there was a deficiency in the DIRRI, such deficiency was inadvertent and not intended.

Her Honour determined she was not satisfied there was any substance in the claim of apprehended lack of independence.

As to the alternative ground that the DIRRI did not sufficiently comply with the requirements of the Act, her Honour noted that s 60 has two requirements:

- to disclose relationships with the company or associates; and
- to explain why those relationships do not disqualify the administrator from acting as administrator.

Her Honour found that in this case, the Liquidators had met these requirements. They had disclosed their firm's business association with the Mawson Group and had explained why the referral relationship did not compromise their independence in carrying out their function as administrators.

As to ASIC's argument that the Liquidators were required to address why the need for investigation of the Mawson Group did not result in any conflict, her Honour found Section 60 of the Act does not require the Liquidators to do this. She noted if there was any conflict to be found, it was be found in the referral relationship, the nature of which was sufficiently disclosed.

ASIC has appealed. The appeal has been heard and judgment is reserved.

Implications

ASIC viewed a need to investigate entities associated with a referrer should be disclosed to creditors. The Federal Court did not consider the Act required such disclosure in this circumstance.

This case demonstrates that:

- Courts do not exercise their discretion in s 503 lightly, especially where no actual lack of impartiality, independence or dishonesty is alleged, as here.
- A liquidator or administrator will not be removed on the basis of apprehended impartiality or independence simply because the administration was referred by an entity connected with the company in liquidation.
- Referrals of business services are commonplace and a lack of impartiality or independence does not automatically follow from a referral relationship.
- It is acceptable for administrators and solicitors, accountants and business advisors who refer work, to form working relationships, subject to these relationships being adequately disclosed in the DIRRI.
- It is important for there to be proper disclosure of relationships in the DIRRI, and to err on the side of an enhanced disclosure. If in doubt it is worth having your solicitor cast a second set of eyes over the DIRRI.

Conclusion

It is clear that her Honour found nothing exceptional in the circumstances and placed great reliance on the professionalism of insolvency practitioners generally and the Liquidators in this matter specifically.

While there will be some circumstances that reach a threshold whereby insolvency practitioners should not take or maintain appointments, the decision suggests that threshold will be fairly high.

Notwithstanding the decision and the result of any appeal, the case is a timely reminder that insolvency practitioners should always step back and make a conscious judgment about all the known circumstances of an appointment before accepting it, particularity where there is a material level of familiarity with those involved.

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