Removing a liquidator through the courts – a recent case update

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Under the provisions of the Insolvency Practice Schedule (Corporations) (IPS) (Schedule 2 of the *Corporations Act 2001*) creditors may seek removal of a liquidator either through a resolution passed at a creditors' meeting, or if that isn't possible, through an order of the Court. The recent case of *In the matter of FW Projects Pty Limited (in liquidation)* [2019] NSWSC 892 provides some guidance as to the factors the Court will consider in determining whether a liquidator's conduct justifies removal.

Background

Creditors are entitled to replace a liquidator by resolution of creditors passed at a properly constituted creditors' meeting. However, it isn't always that simple. This requires a majority of creditors in number, and in value, to agree that the liquidator should be replaced, a position which cannot be guaranteed.

Creditors who cannot rely on passing a resolution are entitled to seek redress from the Court in the appropriate circumstances. Under Division 90-15 of the IPS the Court is armed with the power to make such orders as it thinks fit in relation to the external administration of a company, including the removal and replacement of a liquidator.

Division 90-15 lists a number of matters the Court "may take into account" when exercising its discretion:

- whether the liquidator has faithfully performed their duties;
- whether an action or failure to act by the liquidator is in compliance with the Corporations Act, the Insolvency Practice Rules and any Court order;
- whether the company or other person has suffered loss or damage because of an action or failure to act by the liquidator; and
- the seriousness of the consequences of any action or failure to act by the liquidator, including the effect on public confidence in registered liquidators as a group.

This is by no means an exhaustive list and it is worth considering the currently developing case law for guidance on matters the Court may take into account. One such case is the recent decision by Black J of the Supreme Court of New South Wales *In the matter of FW Projects Pty Limited (in liquidation)* [2019] NSWSC 892.

Relevant overarching principles

Noting the creditors were seeking orders under the new IPS provisions rather than the previous sections of the Corporations Act, Black J outlined some previously developed principles which remain pertinent now [86-89]:

- whether removal would benefit the liquidation and the body of persons interested in it, and the need for confidence in the integrity, objectivity and impartiality of the winding up;
- that rancour between the parties was not sufficient, particularly if the hostility emanated from the party seeking removal, or the creditor would derive an opportunity to manipulate the liquidation[1];
- it should not be seen to be easy to remove a liquidator merely because it can be shown that in one, or possibly more than one, respect, the liquidator's conduct falls short of ideal. Removal entails undesirable consequences in terms of costs and delay[2];
- an order for removal will only be made if it is demonstrated that it would be for the better conduct of the liquidation or "to the general advantage of persons interested in the winding up"[3]; and
- it will be harder to establish a case for removal where a liquidation is well advanced and the liquidator has become acquainted with the company's affairs.[4]

Facts

Creditors of the company sought removal of the Liquidators for various reasons, the main of which can be summarised as follows:

1. an alleged failure to fully investigate dealings with a purported secured creditor and a purported security agreement;
2. an alleged failure to respond adequately to the creditors' requests for documents;
3. an alleged failure to act independently by having pre-appointment discussions with the purported secured creditor, including in relation to funding of the Liquidators' remuneration; and
4. an alleged failure to act independently by engaging the solicitors who acted for the Company (including in relation to the security agreement) and who were a substantial creditor of the Company.

Decision

The Court found comprehensively in the Liquidators' favour.

His Honour held it would be unreasonable to find the Liquidators should have substantially commenced an investigation into the security agreement given appointment occurred only one month before the creditors' application and the creditors only notified the Liquidators of their concerns in relation to it four days prior to the Court application. Furthermore, the Liquidators were unfunded, were expending energy on complying with the creditors' document requests and had committed to funding an investigation into the security agreement. The creditors were already bringing their own proceedings on this point in any event [114].

Similarly, there was no reasonable basis for criticism of the Liquidators in relation to the production of documents. The Liquidators and their solicitors had been subject to an "extended campaign of demanding information" and had provided a "substantial volume of documents in very difficult circumstances" [120].

Neither the Liquidators' pre-appointment discussions with the alleged secured creditor, nor the funding arrangement, warranted their removal. The proposed funding arrangement was disclosed to creditors and Black J noted that "any liquidator" of a company with secured assets may seek the secured creditor's consent to access the property for funding. The pre-appointment discussions did not have more than "a preliminary character" [147].

His Honour found that it would have been preferable had different solicitors been retained at an earlier point (given the potential risks to their objectivity). However, this ground did not warrant removal of the Liquidators as they had appointed the Company's solicitors when there was limited access to funding, the solicitors were already familiar with the Company's circumstances and documents at the time of appointment, and the Liquidators had committed to appointing independent solicitors from the date of judgment [153-156].

Key implications for liquidators

- A liquidator should think carefully before they engage the insolvent company's former solicitors to act for them in the liquidation. While the Court recognised there is no blanket rule against such an appointment, particularly where there are costs savings and other advantages, there is potential for such an arrangement to be viewed as prejudicing the liquidator's independence;
- pre-appointment meetings with creditors of the insolvent company, including where avenues of potential funding are discussed, will not be sufficient to justify a liquidator's removal providing it is clear that such discussions did not hinder their ability to act independently in the liquidation; and
- the absence of funding is a relevant and important factor that the Court takes into account in assessing the reasonableness of a liquidator's actions.

Key takeaways for creditors

- While the door is ajar for creditors to seek removal of a liquidator, it is not "easy" and they must carefully consider the liquidation in all the circumstances and tailor their application, and its timing, accordingly;
- It is unlikely the court will criticise a liquidator for slow responses to overly burdensome requests from creditors, particularly where the liquidation is unfunded. Creditors can avoid objection being taken by a liquidator by keeping requests limited and specific[5]; and
- Whilst creditors must provide a liquidator with a reasonable period to respond to their requests or conduct relevant investigations into the insolvent Company's affairs, it is important to strike whilst the iron is hot before the liquidator's knowledge of the Company's affairs reaches the point where their removal would be an overall detriment to the liquidation. Concerns about impartiality should be raised early and as soon as they become apparent.

[1] *Multi-Core Aerators Ltd v Dye* [1999] VSC 205 at [48]; (1999) 17 ACLC 1172.

[2] *AMP Music Box Enterprises Ltd v Hoffman* [2002] BCC 996 (1001-1002).

[3] *Re St Gregory's Armenian School (in liq)* [2012] NSWSC 1215; (2012) 92 ACSR 588 at [30].

[4] *Re Biposo Pty Ltd* (1995) 17 ACSR 730 at 734; *SingTel Optus Pty Ltd v Weston* above at [165].

[5] See also section 70-15(4) of the Insolvency Practice Rules (Corporations) 2016 as to what is considered a reasonable request and Turkalert dated April 2017 on Rights of creditors to request information under the *Insolvency Law Reform Act* 2016 by Lisa Morrissey and Rosanna Maiorana

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