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14 FEBRUARY 2014

## Case Summary:

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

#### Background

Insolvency practitioners regularly obtain referrals of work from sources including lawyers, business advisors and accounting firms. Indeed, repeat referrals from such sources are commonplace – and are the primary source of work for practitioners in the insolvency industry.

A recent decision in the Federal Court has confirmed there is no inherent apprehension of impartiality or lack of independence where an insolvency practitioner takes an appointment on referral from another party with whom the insolvency practitioner has a pre-existing commercial relationship. The court found that the test for determining whether a hypothetical fair minded observer would apprehend a lack of independence and impartiality was an objective test viewed through the legal fiction of the hypothetical fair minded observer. The knowledge attributable to a 'fair minded observer' would include, among other things:

- awareness about the function and duties of liquidators;
- awareness of the statutory duties that liquidators must perform, including the liquidators' duty to investigate potential

voidable transactions and whether any actions might give rise to some liability under the Corporations Act, or criminal or civil law; and

- knowledge that liquidators' firms are commonly referred voluntary administration and other insolvency work by solicitors, business advisors and accountants.

#### Facts

The fourth and fifth respondents, Walton Construction Pty Ltd and Walton Construction (Qld) Pty Ltd (**Walton**) were experiencing financial difficulty and were placed in administration. Prior to going into administration, Walton transferred assets and assigned debts to companies connected with a group called the Mawson Group. Walton also appointed the first, second and third respondents, who were each liquidators from the firm Lawler Draper Dillon, as administrators on the recommendation of the Mawson Group.

ASIC alleged that the Mawson Group had been involved in the administration of three other companies, where there were antecedent transfers of assets and debt assignments to entities connected with the Mawson Group. In all three of the



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administrations, persons from Lawler Draper Dillon had been appointed as administrators.

In the declarations of relevant relationships (known as a 'DIRRI'), the liquidators declared that Walton was referred to them by the Mawson Group. The DIRRI stated: 'Referrals from solicitors, business advisors and accountants are commonplace and do not impact on our independence in carrying out our functions as Administrators'.

ASIC applied to the Federal Court for an order under s 503 of the *Corporations Act 2001* (Cth) (**Act**) for the removal of the liquidators on the grounds that the liquidators lacked independence and impartiality.

ASIC also sought declarations that the liquidators had contravened s 436DA of the Act by making deficient DIRRI on their appointment as administrators.

## Relevant legislation

Section 503 of the Act provides that: '[t]he Court may, on cause shown, remove a liquidator and appoint another liquidator'.

Section 436DA of the Act provides:

(2) As soon as practicable after being appointed, the administrator must make:

- (a) a declaration of relevant relationships; and
- (b) a declaration of indemnities.

Failure to comply with s 436DA is an offence under s 1311(1) of the Act.

A 'declaration of relevant relationships' regarding an administrator

of a company is defined under s 60(1) as:

(1) ... a written declaration:

(a) stating whether any of the following:

- (i) the administrator;
- (ii) if the administrator's firm (if any) is a partnership--a partner in that partnership;
- (iii) if the administrator's firm (if any) is a body corporate--that body corporate or an associate of that body corporate;

has, or has had within the preceding 24 months, a relationship with:

- (iv) the company; or
- (v) an associate of the company; or
- (vi) a former liquidator, or former provisional liquidator, of the company; or
- (vii) a person who is entitled to enforce a security interest in the whole, or substantially the whole, of the company's property (including any PPSA retention of title property); and

(b) if so, stating the administrator's reasons for believing that none of the relevant relationships result in the administrator having a conflict of interest or duty.

## The Federal Court decision

Her Honour Justice Davies noted that s 503 gives the court a discretionary power to remove a liquidator where it appears that the liquidator is in a position of apparent conflict. A liquidator must be independent and impartial and be seen to be independent and impartial. The discretion to remove a director may be exercised where a hypothetical fair minded observer would perceive a lack of independence or impartiality on the part of the liquidator.

ASIC argued that the asset sales and debt assignments to companies connected with the Mason Group effectively resulted in the transfer of a significant part of the Walton business to those companies. There was a need to investigate these transactions to determine whether they were uncommercial transactions or whether the directors had breached their duties. There was also a need to determine whether the Mawson Group was involved in any breaches of the Act.

ASIC said it was not appropriate for the liquidators to investigate the Mawson Group's involvement because Lawler Draper Dillon had an ongoing commercial relationship with the Mawson Group through which they generated their work. There was a perception that the liquidators could not be impartial when investigating the transactions and would favour interests associated with the Mawson Group at the expense of the interests of the creditors.

Her Honour noted that there must be a logical connection between the matters that are said to impede or inhibit the liquidators from acting impartially in the interests of all creditors. She noted that liquidators are commonly referred work by solicitors, business advisers and accountants. There was nothing about the referral that would cause a fair minded observer to believe that the

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liquidators were not impartial. Moreover, liquidators have statutory duties and responsibilities that they must discharge.

ASIC also argued that the liquidators were required to disclose in their DIRRI the circumstances of their appointment as administrators by referral of the Mawson Group. In particular, ASIC said the liquidators had to explain why they believed the referral relationship with Mawson Group did not result in any actual or perceived conflict of interest, pursuant to s 60(1)(b) of the Act.

Davies J considered the language of s 60. Her Honour noted that the section contains two requirements: first, the requirement to disclose relationships with the company or associates; and second, the requirement to explain why those relationships do not disqualify the administrator from acting as administrator.

In this case, the liquidators had met these requirements. They had explained why the referral relationship did not compromise their independence. Section 60 did not require the liquidators to go further in explaining why the possible need to investigate the Mawson Group did not result in any conflict. Davies J considered that if there were any conflict of interest or duty, it was to be found in the referral relationship that had been disclosed.

Davies J was not convinced there was any substance in the claim of apprehended lack of impartiality and independence. Her Honour also declined to provide the declaration sought by ASIC regarding the DIRRI.

## Comment

The decision illustrates that the courts appreciate the commonplace nature of referral of business services and that a lack of impartiality or independence does not necessarily follow

from a referral relationship.

The case reaffirms that a liquidator or administrator will not be removed on the basis of apprehended impartiality or independence merely because the liquidator has been referred by an entity connected with the company in liquidation.

Administrators should not be afraid of forming strong commercial relationships with lawyers, business advisers or accountants who may refer them work, so long as those relationships are properly disclosed in the DIRRI.

Contact: Jarrod Munro

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## For further information please contact:

**Jarrod Munro**, Partner

Phone (direct) **+61 3 9608 2139**

Mobile **+61 409 908 808**

Email [j.munro@cornwalls.com.au](mailto:j.munro@cornwalls.com.au)