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23 JULY 2014

Case Study:
ASIC v Franklin (liquidator), in the matter of Walton Constructions Pty Ltd [2014] FCA 85

Background

In a recent decision, the Federal Court of Appeal found that administrators were in a position of apprehended or perceived lack of independence or impartiality in accepting an appointment that was referred to them by a regular referrer of work. The court also found that the Declarations of Relevant Relationships (known as a 'DIRRI') given by the administrators complied with the statutory requirements under section 436DA of the *Corporations Act 2001* (Cth) (**Act**). The DIRRI had disclosed a referral relationship through which the administrators were appointed and stated that this relationship did not affect their independence as administrators.

The court affirmed the decision of the trial judge that the DIRRI was sufficient, even though the DIRRI did not explain in detail why the referral relationship did not give rise to a lack of independence and impartiality.

However, the court overturned the trial judge's decision regarding the test of perceived lack of independence and impartiality. A more stringent test was applied and, as a result, ASIC obtained orders removing the liquidators on the ground of apprehended bias.

The decision has serious implications for insolvency practitioners, given that referral relationships are commonplace and a major source of work.

Facts

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. The directors of Walton then appointed the respondents, each of whom was a liquidator with the firm Lawler Draper Dillon, as administrators on the recommendation of the Mawson Group. The administrators were subsequently appointed as liquidators.

When the administrators were appointed as liquidators, it became necessary for them to investigate various pre-administration transactions involving the Mawson Group.

ASIC alleged that the Mawson Group had been involved in the administration of three other (unrelated) companies, where there were antecedent transfers of assets and debt assignments to entities connected with the Mawson Group. In all three administrations, persons from the same firm of chartered accountants had been appointed as administrators.

In their 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'.

At the first meeting of creditors, some concerns were raised by various creditors regarding the Mawson Group's involvement in pre-appointment transactions, but no concerns were aired regarding the circumstances of the administrators' appointment. The court also refused to put any weight on an assertion by ASIC that creditors had raised concerns with ASIC regarding the appointment.

ASIC applied to the Federal Court for an order under s 503 of the 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.

Decision at first instance

Her Honour Justice Davies considered that the discretion under s 503 to remove a liquidator may be exercised where a hypothetical fair-minded observer would perceive a lack of independence or impartiality on the part of the liquidator.

Davies J held that there was nothing about the referral of the liquidators by Mawson Group that would cause a fair-minded observer to believe that the liquidators were not impartial. It is commonplace for liquidators to be referred work by solicitors, business advisers and accountants. Moreover, liquidators have statutory duties and responsibilities that they must discharge, which the fair-minded observer would be aware of.

Davies J also found that s 60 of the Act did not require the liquidators to explain why the possible need to investigate the Mawson Group did not result in any conflict. It was sufficient that the referral by the Mawson Group had been disclosed. Further information on the first instance decision can be found **here.**

Decision on appeal

Apprehended bias

His Honour Justice White determined that the test applied by Davies J was incorrect in that her Honour had asked whether the hypothetical fair-minded observer *would* perceive a lack of independence. The appropriate question was whether the fair-minded observer *might* reasonably apprehend that the liquidators *might not* discharge their responsibilities with independence and impartiality (the so-called 'double might' test).

The test applied by White J was therefore a more stringent test, concerned with 'possibility' and not 'reasonable expectation'. He found that a hypothetical fair-minded observer would consider the revenue of the liquidators from referrals by the Mawson Group in the previous two financial years to be significant. That observer might come to the conclusion that the liquidators may not wish to put their continued receipt of income in jeopardy.

Further, White J held that a fair-minded observer might reasonably apprehend a lack of impartiality due to the Mawson Group's involvement as participants in the pre-administration transactions and their role in influencing the appointment of who would examine those transactions.

White J came to these conclusions, even though no evidence existed of actual bias.

Failure to disclose details of referral relationship

The failure to disclose details regarding investigation of the Mawson Group in the DIRRIs did not affect the issue of apprehended bias. White J noted that, in large and complex administrations, it may not be practical for liquidators to deal with all matters in the DIRRIs in great detail. In any event, the liquidators were aware of the issues and had sought legal advice on the pre-administration transactions.

His Honour Justice Robertson found that s 60 required an administrator to disclose relationships between the administrator and an 'associate of the company'. The section did not require the administrator to give reasons as to why there was no perception of a lack of independence.

Robertson J also considered that the Insolvency Practitioners Association of Australia's guide entitled *Code for Professional Practice for Insolvency Practitioners* should not be used in order to construe the provisions of the Act, because it was not referred to in the explanatory memorandum to the Act and it was not extraneous material of a type to which the court could have referred.

Comment

The Full Court has confirmed that insolvency practitioners will be held to a strict standard for perceived lack of independence and impartiality.

While referral relationships may not of themselves give rise to a perception of lack of independence and impartiality, insolvency practitioners may now be required to carefully consider whether it is appropriate to take an appointment in circumstances where the referrer is responsible for a 'significant amount' of the firm's revenue, and/or where the referrer is involved in any pre-appointment transactions that may require investigation.

A referral relationship should be disclosed in the DIRRI but it is not necessary to explain in great detail why a referral relationship will not give rise to a perception of lack of independence and impartiality, so long as the relationship is disclosed.

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