

Conflict of Interest and the Removal of Liquidators

by Diana Lau Ann Na

A liquidator is appointed for the winding up of a company, whether it is a compulsory winding up by the court,¹ or a winding up initiated by its members² or creditors.³

The liquidator's primary task is to wind up the affairs of the company and to distribute its assets to the parties interested in the winding up.⁴ In performing his duty, the liquidator will:

- (a) Investigate the affairs and assets of the company;
- (b) Investigate the conduct of its directors and other related persons;
- (c) Investigate claims made by creditors and third parties;
- (d) Realise the assets of the company assets;
- (e) Distribute the proceeds of the liquidation to creditors and contributories.⁵

The winding up of a company, being proceedings *in rem*, with stakeholders having different rights and priorities to a common fund, the liquidator must act impartially between creditors, shareholders and, sometimes, even directors and employees. Otherwise, the court may remove the liquidator.⁶

One ground for removal of the liquidator is when he is in a position where his duty and interest are in conflict. The guiding principle is that the liquidator must be, and

seen to be, independent. Liquidators who are members of sizeable organisations might face particular problems due to their association with creditors, shareholders or others associated with the insolvent company at different times.

The liquidator may be called upon to investigate or question the actions taken or advice given by various parties in relation to the company prior to the winding up. A potential conflict may arise where the liquidator has a prior association with any of these persons. In particular, where it involves clients who have previously retained him for his services in some capacity.

A conflict may arise when the duty of the liquidator in the winding up is affected by his need to support the competence of his own previous work in connection with the company and the correctness of his conclusions.

Another source of possible conflict would be the liquidator's previous association with some stakeholders in the winding up. The previous association may give impression that he may not be impartial in his dealings with the competing interests of different creditors and shareholders.

This much is clear from the authorities: Liquidators will only be removed if there is a real, as opposed to a theoretical, possibility of conflict.⁷

The court will not limit the kind of cause which is required to remove a liquidator.⁸ It has to be determined on a case-by-case basis. The approach of the court has been summarised as follows:

"The courts will consider whether there is any real risk of the liquidator not being able to act impartially or objectively in relation to company's affairs and they have removed a liquidator

1 Companies Act 2016 ("CA 2016"), s 432(1)(a) for compulsory winding up. All references shall be to this Act, unless stated otherwise.

2 Section 432(2)(a), for members' voluntary winding up

3 Section 432(2)(b), for creditors' voluntary winding up

4 Section 445: members' voluntary winding up; s 450: creditors' voluntary winding up

5 Section 452

6 Section 453(2) reads: "The Court may, on cause shown, remove a liquidator and appoint another liquidator."

7 Andrew R Keay, *McPherson's Law of Company Liquidation* (Sweet & Maxwell UK, 2nd Ed, 2009) at p 472, para 8.046

8 *Keypak Homecare Ltd, Re* (1987) 3 BCC 558

whose independence or fiduciary position was compromised by personal indebtedness to the company, or by his or her claim to rank as a creditor of the company, or because of a conflict of interest, or by the liquidator's efforts to prevent misfeasance proceedings from being taken against him or her.

"Likewise, the fact that the liquidator has been closely associated with promoters or directors whose conduct required investigation, or that he or she has manifested a tendency to favour certain interests at the expense of others, or is motivated by personal animosity toward some of those interested in the winding up, or has become too familiar with a major creditor, or is a partner in a firm whose relationship with the company may need to be investigated might indicate such a lack of probity, impartiality, or independence, as makes it proper that the court should remove the liquidator from office."⁹

In some cases, liquidators have resigned or were removed by the court because of prior association with the company or other entities associated with it:

- (a) The liquidator had to adjudicate on whether payments made to his firm immediately before the company went into liquidation constituted an unfair preference. There was an appearance of a possible conflict of interest. The liquidator was given an opportunity to retire.¹⁰
- (b) The liquidator had a claim against or debt owed to the company. This is a clear example of a conflict between the personal interest of the liquidator and that of the creditors.¹¹

- (c) The liquidator was a director of the company in liquidation. He had a close relationship with the other directors of the company. This was held to be a conflict of interest.¹²
- (d) A group of companies entered into administration and subsequently went into liquidation. The liquidators had been referred the matter by a corporate advisory group with which the insolvency firm of the liquidators enjoyed an ongoing commercial relationship. The corporate advisory group had been advising the companies prior to the liquidation. The companies transacted assets sales and debt assignments with companies connected with the corporate advisory group shortly before they entered into administration. It was the duty of the liquidators to investigate those transactions and whether the corporate advisory group had breached any law. The court held that there was a reasonable apprehension that the liquidators lacked independence and impartiality and that therefore, they should be removed.¹³

On the other hand, the court has recognised that not every prior association will result in a conflict of interest:

- (a) The liquidators had provided accounting services to the company before its winding up. The services included a review of the company's financial affairs and performance as well as the provision of a report arising from that review. No real or perceived conflict of interest was found. The court in fact noted that the liquidators' substantial knowledge of the affairs of the company was likely to assist in the efficient conduct of the liquidation and would be a benefit to creditors as a whole.¹⁴

⁹ *Supra* n 7, para 8.045

¹⁰ *Advance Housing v Newcastle Classic Developments* [1994] 14 ACSR 230

¹¹ *Re Giant Resources Ltd* [1991] 1 Qd R

¹² *Chua Boon Chin v JM McCormack & Ors* [1978] 1 LNS 33 (HC)

¹³ *Re Walton Construction Pty Ltd* [2014] FCAFC 85

¹⁴ *Re Walley, in the matter of Poles & Underground Pty Ltd (Administrators Appointed)* [2017] FCA 486

- (b) The liquidator was a member of an insolvency firm which had conducted an investigation into the affairs of the company before its winding up. It was alleged that a partner in the insolvency firm was a personal friend of one of the company's directors. The liquidator did not participate in the investigation and there was no evidence that the liquidator had a need to probe the conduct by the firm of the investigation.¹⁵
- (c) The liquidators put the company's assets on sale and invited open tenders for the sale of shares held by the company in a canning factory. The liquidators accepted the offer of a bidder who turned out to be an audit client of the insolvency firm in which the liquidators were partners.¹⁶ There was no conflict of interest in this situation.
- (d) Partners in a multi-national insolvency firm were appointed as provisional liquidators of a company and receivers of another 80 companies with which the company was connected. There were potential conflicts of interest arising out of the receivers' entitlement to forfeit certain reversionary leases, the provisional liquidators' right to trace the company's moneys in the properties owned by the receivers and debtor/creditor cross-claims. The company applied to remove the provisional liquidators, who had by that time spent a considerable amount of time, money and effort in unravelling the company's affairs.

It was held that a potential conflict of interest had not materialised. There was little prospect of a conflict arising between the receivers and the provisional liquidators as in most cases the lenders had appointed receivers to the properties owned by the companies under receivership.

Those companies which did not fall into that category could be adequately protected by ensuring that the receivers acted with separate legal advice. There was no useful purpose in replacing the provisional liquidators in the light of the work already carried out.¹⁷

In a market with a limited number of firms having the capacity to handle complex, multi-national insolvencies, it is inevitable that prior association would be found between such firms and the company or a related entity or some other party.

The mere fact that the firm of a liquidator has provided any auditing or other services to the company or a related entity or some other party does not necessarily result in a conflict of interest.¹⁸ The courts have usually taken an objective and pragmatic view of these circumstances. It is always prudent, whenever possible, for a liquidator to disclose any such association to the stakeholders¹⁹ and obtain legal advice prior to accepting the appointment. **LH-AG**

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15 *Pongrass Group Operations Pty Ltd v Lowerpinems Pty Ltd* (1994) 15 ACSR 341

16 *Ooi Woon Chee & Anor v Dato' See Teow Chuan & Ors* [2012] 2 MLJ 713 (FC)

17 *Re Arrows Ltd* [1992] BCC 121

18 *Ooi Woon Chee*, *supra* n 16

19 In *Re YBM Magnex International Inc* (2000) 275 AR 352, the accountant was auditor to several creditors, but the position had been disclosed at the outset, an application by the audit client creditors to remove him as receiver and manager was dismissed. However, in *Canadian Co-operative Leasing Services v Price Waterhouse* (1992) 128 NBR (2nd) 1, the accountant failed to disclose his firm's earlier involvement with relevant companies upon accepting appointment by the court as receiver and manager. The accountant was not only removed, but also deprived of his fees.