COURT EXPECTATIONS OF INSOLVENCY PRACTITIONERS AS LITIGANTS

Paper delivered to the Insolvency Practitioners Association of Australia (Queensland Division)

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The Hon Justice James Douglas

Let me begin with a few truisms and a story. First, the story.

Shortly after I started in practice at the Bar thirty years ago I went to a legal symposium at the Gold Coast. Solicitors were then coming to grips with advertising their practices. Sir John Nosworthy, the senior partner of Morris Fletcher and Cross, now Minter Ellison, opened a panel discussion on that topic with a few examples of how specialist practices might promote themselves – examples that the informed member of the audience could match up with particular firms.

The sample advertisement that has always stuck in my head was peculiarly appropriate for today's audience, but was directed, I thought, at a prominent solicitor who was one of Sir John's former partners:

> "Are you feeling wound down? Let me wind you up!"

I wanted to get that old joke in somewhere but it illustrates something that I might say a little more about later. It isn't just the accountants as liquidators who loom large in this field but the lawyers too. There is a close relationship between the specialist accountants and lawyers who practise in the field but one which needs to respect each

other's differing roles in the system. It is one reason why, for example, the Federal Court allocated liquidators to insolvent companies by a roster. I understand that that Court adopted that practice at least partly from the wish to ensure that the relationships between particular liquidators and particular firms of solicitors remained independent. The Supreme Court's approach has been to permit applicants to nominate their preferred liquidator who is required to state in the consent to act that he or she is not aware of any conflict of interest or duty that would make it improper for him or her to act. That approach seems to me to reflect the practical, market advantages that stem from recognising that many litigants or solicitors will prefer one liquidator over another because they perceive that some are more effective in the role than others.

Truisms

Let me proceed to the truisms. Most of what I will say focuses on the role of liquidators as they are the officers of the Court whom we encounter most. Much of what I will say about them will also apply to such people as bankruptcy trustees and receivers; cf, however, *Martyniuk v King* [2000] VSC 319 at [38] in respect of receivers.

The obligations of liquidators as officers of the court are found partly in the *Corporations Act* 2001 (Cth) and also in the judicial decisions that deal with their powers, obligations and potential liabilities. Section 488 of the Act permits provision to be made by rules or regulations to allow liquidators to exercise or perform the powers and duties conferred and imposed on the Court by Part 5.4B of that Act subject to the control of the Court. Rule 7.10 of Schedule 1A of the *Queensland*

Uniform Civil Procedure Rules 1999 makes it clear that the powers and duties conferred or imposed on the Supreme Court by Part 5.4B, which deals with winding up on insolvency or by the Court, in respect of the matters mentioned in s 488(1) of the Act may be exercised or performed by a liquidator appointed by the Court as an officer of the Court and subject to the control of the Court.

The liquidator is appointed by the Court to collect and realise the company's assets for the benefit of those interested in the winding up and, even in the case of a voluntary winding up, the Court is in the background to be referred to "if the necessity should arise"; *Re Phoenix Oil and Transport Co Ltd (No 2)* [1958] Ch 565, 570. There are several other fairly straightforward propositions that are not controversial. Liquidators are the agents of the company in liquidation and are appointed by the Court on the basis that they have a high degree of commercial expertise which the Court itself lacks. The liquidator is regarded as a fiduciary agent who must act honestly and exercise his or her powers in good faith for the purpose for which the powers are conferred. The liquidator has a duty to the whole body of shareholders, the creditors and the Court. Although not the employee of the Court, the liquidator is its representative and must act in a "high minded" manner and not take advantage of his or her strict legal rights if this has the effect of unjustly enriching the company in liquidation at the expense of an innocent party. Nor will the Court allow a liquidator to take advantage of mistakes or to act in a "shabby" or underhanded manner. These general principles are recited usefully in *Australian Corporation Law, Principles and Practice* [5.4.0395].

Another useful summary is found in *Halsbury's Laws of Australia*:

> "**[120-13295] Introduction** In a compulsory winding up, the liquidator appointed is an officer of the court. A liquidator is regarded as an agent of the company and has the power to bind the company. A liquidator must be impartial and is expected to act in a professional manner. A liquidator occupies a fiduciary position. As an officer of the company a liquidator must act in good faith and not make improper use of information or use his or her position for an improper purpose. As a representative of the court, a liquidator cannot unjustly enrich the estate of the company in an unfair manner. A liquidator must also ensure that no conflict between interest and duty arises and must not delegate his or her discretion. A liquidator must act faithfully and fairly, and must exercise the degree of care and diligence that a reasonable person in a like position would exercise. A liquidator must also act within a reasonable time frame. The provision of funds by a stranger to litigation for the purpose of enabling the liquidator to pursue worthwhile claims on behalf of the company is not necessarily to be considered as constituting maintenance or champerty. It is arguable that a liquidator should advise shareholders of the company that they may have a personal cause of action. The insolvency administration of two companies conjointly is something that can only occur in exceptional circumstances."

The maintenance or champerty issue was clarified recently by the High Court in *Campbells Cash and Carry Pty Limited v Fostif Pty Limited; Australian Liquor Marketers Pty Limited v Berney* [2006] HCA 41.

The rule in *Ex Parte James*

You have asked me to speak about the Court's expectations of insolvency practitioners as litigants. The main area on which I shall focus is what has been described as the "elusive and difficult principle" in *Re Condon; Ex Parte James* (1874) LR 9 Ch App 609. That principle has been expressed as follows:

> **"…** that a trustee in bankruptcy, as an officer of the court, should act in an exemplary way and should not demand his or her entitlement to property or money where that property or money ought, from a moral standpoint, be retained by some other person." (See *The Laws of Australia* para. 3.9.47.)

An example of the use of the rule occurred in *Re Tyler; Ex parte Official Receiver* [1907] 1 KB 865 where a trustee was directed to pay to the wife of a bankrupt

premiums which she had paid upon a policy of life insurance on the bankrupt's life in the erroneous belief that she was entitled to the proceeds of the policy.

Gummow J in the Federal Court in *Hartogen Energy Ltd (in liq) v The Australia Gas Light Co* (1992) 36 FCR 557 was asked to apply the rule to preclude liquidators from asserting any claim to privilege in respect of documents they held relevant to litigation. His Honour held that there was no impropriety or unconscientious conduct by the liquidators in proceeding as they did, and they should not be required to waive legal professional privilege. This was so where the respondents were resisting a claim by the liquidators and themselves had commenced a cross-claim for substantial damages. He went on to say that, in a given case, the court, pursuant to the then equivalent of s 477(6) of the Act, may direct a liquidator to waive legal professional privilege, but if the court were to do so, it would act in exercise of the statutory power rather than any generally formulated abstraction of the rule in *Ex parte James*

He examined the doctrinal basis of the rule, related it to a number of cases where it was used to justify the recovery of payments made under a mistake of law and concluded at 574-575:

> "Accordingly, there is much to be said for the location of the doctrinal basis of the rule in *Ex parte James* in the law as to the recovery of mistaken payments. That, as I have indicated, is how the matter has been seen by Professor Hanbury and by the United States authorities to which I have referred. In Australia, *Ex parte James* has been, as I have indicated, discussed by two members of the High Court in *Downs Distributing* but not in decisive terms.
> However, in England itself *Ex parte James* has been treated as propounding some wider principle. The turning point was the decision of the Court of Appeal in *Re Tyler; Ex parte Official Receiver* [1907] 1 KB 865 at 868-869, 873, where Vaughan Williams LJ and Farwell LJ respectively held that in the earlier case when James LJ spoke of money 'which in equity belonged to someone else', he was using those words in a popular sense and not in terms of ownership as understood in a court of equity. It followed that *Ex parte James* was not limited to cases where money had been paid under a mistake of

> law. Further, in *Re M and J De Wit, Bankrupts; Ex parte Custom Credit Corporation Ltd* (1961) 19 ABC 63, Paine J took *Re Tyler* (supra) as meaning that the rule in *Ex parte James* 'is beyond the established rules of law and equity'.
> The result, in my view, is that many of the cases applying in England and Australasia the so-called rule in *Ex parte James* in company liquidations are better understood as outlining the manner in which the court controls the exercise by liquidators of their powers conferred by the relevant legislation."

Shortly after that judgment the High Court decided in *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353 that a rule precluding recovery of money paid under a mistake of law did not form part of the law of Australia. So that rationale for the rule no longer applies. Does it have a wider operation? The English and other more recent Australian cases suggest that it does.

Gummow J, in *Hartogen* at 575-576, pointed to the endeavour made to state in propositional form the effect of the English cases, by Walton J in *Re Clark (A Bankrupt); Ex parte Trustee v Texaco Ltd* [1975] 1 WLR 559, 563-564:

> "His Lordship said that for the rule in Ex parte James to operate the following 'conditions' must be present:
> (1) There must be some form of enrichment of the assets of the bankrupt by the person relying upon the application of the rule, this being 'a universal feature of all the cases in which the rule has been applied'.
> (2) The claimant must not be in a position to submit an ordinary proof of debt, the rule existing not merely to confer a preference on an otherwise unsecured creditor, but to provide relief to a claimant that would otherwise be without relief.
> (3) The rule applies so as to nullify the claim the liquidator or trustee otherwise would have if in all the circumstances of the case, as an honest man he would nevertheless be bound to admit that it would not be fair 'that I should keep the money; my claim has no merits'.
> (4) The rule by no means necessarily restores the claimant to the status quo ante and it applies only to the extent necessary to nullify the enrichment of the estate."

He considered a modification of that expression of the rule by pointing out that there is a particular difficulty in applying the rule in *Ex parte James* to exclude a trustee or

liquidator from prosecuting a statutory claim, because a court can hardly be put in the position of having to determine whether particular legislation fits some preconceived notion of a desirable general policy and refused the order sought in *Hartogen* on that analysis also.

That approach was also adopted recently by Campbell J in the New South Wales Supreme Court in *Hypec Electronics Pty Ltd (in liq) v Mead* (2003) 202 ALR 688, 741-742, [195]-[196]. In the appeal from that decision, *Hypec Electronics Pty Ltd (in liq) v Mead* [2004] NSWCA 221, Tobias JA also considered whether the rule was limited to cases of the recovery of money paid under a mistake of law as urged by Gummow J in *Hartogen.* Because of his other reasons for disposing of the appeal he did not need to resolve that issue but did say this at [96]-[98]:

> "[96] In *Star v Silvia (No 1)* (1994) 12 ACLC 600, Young J agreed with Gummow J in *Hartogen* that the rule, or principle, in *Ex parte James* was better understood as outlining the manner in which the court controls the exercise by liquidators of the powers conferred on them by the relevant legislation. Young J considered that the principle exists but recognised that its exact content and scope had been the subject of both judicial and academic debate. He then observed (at 603):
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> > 'The core of the principle is that if the court's officer is under an obligation of conscience or equity to a person, the court will direct the liquidator to carry out that obligation.'
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> Again, at 604, Young J observed:
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> > 'The principle should be applied to ensure that the liquidator does not hold property where there are claims of conscience against the property, without recognising those claims of conscience.'
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> [97] These statements seem to acknowledge that the principle has a wider and more flexible operation than that which Gummow J in *Hartogen* was prepared to recognise. However, at least in Australia, there does not appear to be any appellate authority as to the correctness or otherwise of Gummow J's view that the operation of the rule should be confined to monies retained by a trustee in bankruptcy or liquidator which have been paid to him purely under a mistake of law.
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> [98] Given my view that the liquidator's challenges to the primary judge's finding that the liquidator was estopped from claiming the four properties should be rejected, it is unnecessary to determine the issues raised by the liquidator's submissions. Without finally expressing a concluded view on the matter, my own opinion is that the principle ought to have a wider

> operation than that which Gummow J preferred in *Hartogen* and that there is no reason in principle to confine it to money which has been paid under a mistake of law. This is especially so where it is common ground that the principle is better understood as outlining the manner in which the court has a wide discretion to control the exercise by liquidators of their statutory powers pursuant to s 477(6) of the *Corporations Act*. I would therefore prefer what I regard as the broader operation of the principle articulated by Young J in *Star v Sylvia*. However, I repeat that this is not a concluded view."

That subsection, s 477(6), provides that the exercise by the liquidator of the powers conferred by s 477 is subject to the control of the Court and any creditor or contributory or ASIC may apply to the Court with respect to any exercise or proposed exercise of any of those powers.

The most recent discussion of the operation of the rule in Australia appears to be the decision of Gzell J in *Young v ACN 081 162 512* (2005) 218 ALR 449 at [21]-[30]. His Honour referred to the issue whether the rule was limited to the recovery of money paid under mistake of law and then drew attention to the decision of Campbell J in *Hypec Electronics Pty Ltd (in liq) v Mead* (2003) 202 ALR 688 where his Honour concluded at [177] that the rule had been applied in many circumstances outside the recovery of moneys paid under mistake. Again Gzell J did not need to resolve the issue and referred also to the analysis of Walton J in *Re Clark* as modified by Gummow J in *Hartogen* as providing another analytical approach to the use of the principle.

Accordingly there is a live area for debate in Australia about the nature of the court's expectations of liquidators. Is the rule in *Ex parte James* limited to situations where payments made by mistake of law are sought to be recovered from the company in liquidation or does the rule extend to the wider circumstances expressed by Walton J

in *Re Clark*? Having articulated the question I will not give my answer to it but leave it to you to litigate it – perhaps before me! It is probably enough to say, however, that the wider view of the application of the rule is safer for liquidators who do not want to be caught up in litigation. It may also be more consistent with the "high minded" behaviour expected of them by the Court.

General supervisory role of the Court

In another recent decision in the Hypec litigation in New South Wales Campbell J has summarised in useful detail other sources of the Court's supervisory powers. See *Hypec Electronics Pty Ltd (in liq) v Mead; BL & GY International v Hypec Electronics Pty Ltd (in liq)* (2004) 61 NSWLR 169 [75]-[95] where his Honour referred to s 477(6) which provides that the exercise by the liquidator of the powers conferred by that section is subject to the control of the Court, to s 536 dealing with supervision of liquidators and ss 479(3), 533(3), and 540 as well as the inherent power of the court to supervise and guide the activities of its own officer. His Honour also considered the nature of the supervisory power where the liquidator was variously plaintiff and defendant and where the company in liquidation was the plaintiff. Another useful analysis of the powers and duties of liquidators whether or not they are court appointed can be found in *Re Lofthouse and ASIC* [2004] AATA 327 at [54]-[63] and attention should also be paid to the power in s 1321(d) to appeal to the Court in respect of an act of a liquidator, an area where Courts are reluctant to interfere in assessing the commercial prudence of a transaction unless persuaded that the liquidator has acted in a way that no reasonable liquidator would; McPherson, *The Law of Company Liquidation* (4th ed., 1999) at 393.

Another aspect of the application of these principles, stemming from the fact that liquidators are officers of the Court, is that the Court will protect its officers from spurious or vexatious litigation and will protect the integrity of the winding up process to ensure no wrongful interference with that process. Accordingly a prospective litigant must obtain leave to sue a Court appointed liquidator and, in seeking such leave, demonstrate that its claim has sufficient merit; *Mamone v Pantzer* (2001) 36 ACSR 743, 746 [4] per Santow J.

Other Matters

My original letter of instructions asked me to look not only at what the Court expected of insolvency practitioners as litigants but also to what the Court looks for in providing assistance to court officers seeking directions and how may insolvency practitioners better use the commercial list or the supervised cases list.

These are practical matters. In seeking to answer them I sought some aid from the registry staff. They seem satisfied with the administrative procedures currently in place and could not identify any particular problem areas in the seeking of directions or the use of the commercial list or the supervised cases list. One issue I was reminded of was the need for liquidators to prepare a bill similar to a solicitor's bill of costs when seeking to have their costs determined by the Court under s 473(3); see *Re Solfire Pty Ltd (in liq) (No. 2)* [1999] 2 Qd R 182.

Of course it is necessary to be prepared when you go to Court, to know what you want and what entitles you to seek it, what legislation is relevant, what the rules provide

and what the relevant cases are touching on the issues. You will rely on your lawyers to advise you about those issues but many of you will be very familiar with our requirements also. You are professionals and regular litigants so more is expected of you than is expected of the lay person.

I am told that you regularly use the supervised list and the commercial list. That is appropriate for the sorts of matters companies in liquidation are involved in and, again, the Courts' expectations of litigants using those lists are that the greater resources devoted by the Court to cases on them require the litigants to meet the directions and orders made efficiently and in a timely fashion. As far as I can tell your members use those lists effectively. If you have any particular queries I am happy to field them and to point you to the Court staff who may be able to assist you in resolving them.

Thank you for the invitation to speak. I appreciate the opportunity and hope that our relations with you as court officers continue to be as cordial as they have been in the past. It is useful to set up a dialogue of this type with the Court and something that I suggest could be done on a regular basis.