SUPREME COURT OF VICTORIA

Re NATIONAL SAFETY COUNCIL OF AUSTRALIA, VICTORIAN DIVISION

APPEAL DIVISION

YOUNG C.J.
MURPHY and MARKS JJ.

2–3, 8 May 1989

Companies — Winding up — Liquidator — Appointment of — Conflict of interest — Independence of liquidator.

(1) An order appointing a liquidator under s. 372(1) of the *Companies (Victoria) Code* is a separate order from the winding up order and is interlocutory.

(2) The guiding principle in the appointment by the court of a liquidator is that he must be independent and must be seen to be independent.

(3) A liquidator who is a partner in a firm whose relationship with the company may be required to be investigated by the liquidator cannot be seen to be independent.

Application for leave to appeal

This was an application for leave to appeal from an order made by O'Bryan J. in which his Honour ordered that the National Safety Council of Australia, Victorian Division be wound up by the court and that Michael James Humphris be appointed liquidator. The facts are stated in the judgment of the court.

A. J. Myers Q.C. and *K. W. S. Hargrave* for the first appellant.
A. H. Goldberg Q.C. and *J. G. Santamaria* for the second appellant.
W. T. Houghton for the third appellant.
R. A. Finkelstein Q.C. and *J. V. Kaufman* and *B. B. Braun* for the company.
A. Chernov Q.C. and *P. J. Jopling* for the liquidator.

Cur. adv. vult.

The Full Court (**Young C.J., Murphy** and **Marks JJ.**) delivered the following judgment: The State Bank of Victoria and the State Bank of South Australia come before the court seeking to appeal from an order made by O'Bryan J. on 24 April in which his Honour ordered that the National Safety Council of Australia Victorian Division (which we shall refer to as "the company") be wound up by the court and that Michael James Humphris be appointed liquidator. The banks are creditors of the company and appeared before O'Bryan J. having given notice under the rules of their intention to do so and to support the petition for winding up which was presented by the company. The ground of the petition was that the company was unable to pay its debts.

As will appear, there are special reasons why the matter should be treated urgently and those reasons led us to interrupt the work of this court and

to take the case at short notice. Those appearing before the court have raised no objection to the abridgment of time involved. Indeed the fact that the case was called on only eight days after the order appealed from was made disproves the often uninformed contention that an appeal to this court cannot be heard in under about four months. Often that may be the time which elapses between the original decision and the hearing of an appeal but most of that time is usually taken up in preparing the appeal books. This case shows that if the party seeking to appeal really wishes to be heard promptly a little determination will enable him to do so.

The urgency of the matter has led us to prepare a judgment which, though it resolves the questions involved, does not elaborate upon the law. However, there is no doubt about the appropriate legal principles to be applied and having reached a clear view as to what the outcome should be, it is in the interest of all concerned that we should give judgment as soon as possible.

The company is incorporated as a company limited by guarantee under the *Companies (Victoria) Code* and the evidence shows that on 22 March this year Michael James Humphris, a member of the accountancy firm of Ernst & Whinney, was appointed provisional liquidator. That appointment was made on the application of the company. As provisional liquidator Mr. Humphris and his staff did much detailed work totalling in all about $200,000 in value and on the hearing of the petition for a winding up order, the company invited O'Bryan J. to appoint Mr. Humphris as the liquidator of the company. It was submitted to O'Bryan J. that much of the benefit of the work done would be lost if that appointment were not made. The proposal was supported by a number of creditors. O'Bryan J. acceded to the application and appointed Mr. Humphris liquidator.

Two major creditors, however, opposed the appointment of Mr. Humphris as liquidator. They are the State Bank of Victoria and the State Bank of South Australia. Each of those banks is thought to be an unsecured creditor of the company because it now seems as if the debenture charges which they were given to secure loans made to the company were charges over non-existent or fictitious assets. The State Bank of Victoria is owed about $107 million and the State Bank of South Australia about $17 million. The total liabilities of the company are thought to be in the order of $300 million and there is likely to be a shortfall of about $200 million. The two banks together with other financial institutions which support their view are owed approximately $185 million and thus constitute a majority in value of the unsecured creditors of the company.

The banks now come to this court not to challenge the winding up order but only to challenge the appointment of Mr. Humphris as liquidator.

Each of the banks filed a notice of appeal as though they had an appeal to this court as of right against the order appointing Mr. Humphris as liquidator, but it is a question whether that order is final or interlocutory. Applying the test in *Carr v. Finance Corporation of Australia Ltd. (No. 1)* (1981) 147 C.L.R. 246; 34 A.L.R. 449, an order appointing a liquidator of a company would appear clearly to be an interlocutory order. The test to be derived from that decision is: Does the order finally dispose of the rights of the parties? The test may be said to have been formulated first by Lord Alverstone C.J. in *Bozson v. Altrincham Urban District Council* [1903] 1 K.B. 547. It seems clear that this order does not finally dispose

of the rights of the parties, for a liquidator may be removed at any time, he may with permission resign or an extra or additional liquidator may be appointed. Further, his powers may be varied from time to time by the court.

During the course of argument counsel was asked whether the order for winding up of the company by the court and the appointment of Mr. Humphris as liquidator might be regarded as a single order of a final character, the appointment of the liquidator being merely an incident of it, or whether the proper view was that there were two orders made, the first an order for winding up and the other the appointment of a liquidator. There is authority in the Court of Appeal in England to the effect "that it would be convenient that appeals from compulsory winding up orders should be treated as interlocutory and not as final appeals" (*sic*). The authority is *Re Naval, Military Civil Service Co-operative Society of South Africa Ltd.* [1903] W.N. 120. The report of that case is a very brief report of an application for security for the costs of an appeal from an order for the compulsory winding up of a company and it may well be that the observation which we have quoted was merely concerned with the manner in which the Court of Appeal of that time managed its business. It may have been merely a means of ensuring that an appeal from a winding up order should be heard promptly. However that may be, we have not seen the question whether a winding up order or any ancillary directions contained in it is final or interlocutory analysed in terms of our statute. The desirability of delivering this judgment as soon as possible precludes the possibility of further research into that question but in any event it is unnecessary to decide it for the purposes of the present case. It is clear that an order appointing a liquidator under s. 372(1) of the *Companies (Victoria) Code* is a separate order from the winding up order and is interlocutory. It was made not on the motion for a winding up order but on a summons for the appointment of a liquidator which was heard at the same time. There is no reason why the two orders should be on the same piece of paper and it is to be remembered that the order for winding up is made under s. 364 of the Code and not under s. 372. Further, there is no reason why the order appointing a liquidator should be made on the same day as the order for winding up although it will generally be desirable that the two orders are made at the same time. We shall deal later with the consequences of the conclusion that the order appointing a liquidator is an interlocutory order.

The basis of the banks' opposition to the appointment of Mr. Humphris is that there is or will be a conflict of interest or there will appear to be a conflict of interest if he remains as liquidator. That is to say, Mr. Humphris will be in a position where his personal interest and his duty as liquidator may conflict or may appear to conflict.

This possible conflict derived from events which began on 21 December 1988. On that day the company's auditors informed the directors that they had qualified the audit reports of the company for the financial years 1986 and 1987 and were unable to complete financial statements for the financial year 1988. This information caused the directors on 23 December 1988 to retain Ernst & Whinney, chartered accountants, to investigate and report upon the accounting procedures, controls and records of the company.

There was some difference amongst those appearing before the court as to Ernst & Whinney's precise function and terms of reference but in the end nothing requires us to resolve the difference and nothing in this decision turns upon it.

Mr. G. Richardson, a partner in Ernst & Whinney, and Mr. D. Balcombe, then an employee of the firm but now a partner, undertook the task with other employees of the firm. From time to time they reported to the board of the company.

In January and February, Mr. Richardson reported on matters which were needed to improve the basic procedures operating within the accounting system and drew the attention of the board of the company to the possible consequences of weaknesses in prodecures which had been detected by Mr. Balcombe.

Between 23 December 1988 and 21 March 1989, three payments were made to Ernst & Whinney, the arrangement being that their accounts were to be paid within seven days of their being rendered. The last payment made was for nearly $40,000 on Friday, 17 March. A special clearance of the cheque was arranged by Ernst & Whinney.

Messrs. Richardson and Balcombe became concerned about the validity of the financial records and whether they truly reflected the financial position of the company, particularly in respect of the recording, existence and valuation of the major assets of trade debtors and the category of non-current assets known as "containerised safety equipment". The chief executive of the company, one Friedrich, was stood down on 14 March and Messrs. Richardson and Balcombe were for the first time authorised to approach clients, creditors and debtors of the company in order to ascertain the true financial position. It soon became apparent to them that the company was insolvent and should not continue to trade. On Monday, 20 March, Mr. Humphris from Ernst & Whinney's insolvency department became involved for the first time and the following day the directors resolved to liquidate the company and seek the appointment of Mr. Humphris as provisional liquidator. That appointment was made on Wednesday, 22 March.

It was submitted that the payment of $40,000 to Ernst & Whinney was prima facie a preference and O'Bryan J. expressed the view that there was a good arguable case that a preferential payment had in fact been received on 17 March. His Honour thought, however, that the difficulty which that would otherwise have caused in the appointment of Mr. Humphris as liquidator could be overcome by an undertaking from Ernst & Whinney to repay the amount to the provisional liquidator within 72 hours. Upon this undertaking being given, the learned judge ordered that leave be granted to Mr. Humphris pursuant to s. 417(2) of the *Companies (Victoria) Code* to act as liquidator notwithstanding that the firm of which he was a member is a creditor of the company for nearly $40,000.

A more substantial objection was taken to the appointment of Mr. Humphris as liquidator. It was said by the banks that the liquidator would have to investigate the question whether the company might have an action against Ernst & Whinney for failing to investigate the affairs of the company with due diligence and reasonable care. Between December 1988 and March 1989 the company's indebtedness to the State Bank of Victoria increased by about $17 million and its indebtedness to the State Bank of South

Australia by about $27 million, a total of $44 million. In these circumstances the banks submit that they would expect the liquidator of the company to investigate fully whether, if Ernst & Whinney had performed their function properly, the insolvency of the company would have come to light earlier than it did. The company and Mr. Humphris say that there is no foundation for an allegation that Ernst & Whinney did not perform their function with due diligence and reasonable care and that if in the course of the liquidation a conflict arose between Mr. Humphris's duty and his personal interest he would resign as liquidator or one of a number of other courses might be followed: an additional liquidator might be appointed, the liquidator might be removed by the court, and so on. In these circumstances it was said by counsel for the liquidator that there would be great advantage to the creditors in having available for their benefit the work done by Mr. Humphris as provisional liquidator. The costs of that work should not be thrown away until it was clear that there would be a conflict between the liquidator's personal interest and his duty. It seems probable, however, that the real advantage sought to be obtained for the creditors was the work done by Ernst & Whinney in the three months during which they were investigating the accounting procedures of the company. Nothing before us indicates very clearly how significant a saving in costs might be achieved if Mr. Humphris were appointed liquidator. Mr. Chernov emphasised that counsel for the banks had not in any way particularised the allegation made against Ernst & Whinney and, as O'Bryan J. observed, the possible conflict of interest and duty was more apparent than real. Further, it was submitted that no error of principle on the part of the learned judge had been shown.

Before dealing with those submissions, two other points referred to by Mr. Chernov should be noted. The first was that the banks had no standing to appeal since they were not parties to the proceeding before the primary judge. It is true, of course, that pursuant to r. 3.16 of the Companies and Securities Rules a creditor may be heard in a proceeding under the companies and securities legislation without becoming a party but under that rule it is also possible for a creditor to be made a party. Only a party can appeal. In the end, however, Mr. Chernov did not persist in this objection as he conceded that it would be open to this court to make the banks parties to the proceedings *nunc pro tunc*.

The second objection raised by Mr. Chernov was as earlier indicated that the order from which the banks seek to appeal is an interlocutory order and no application for leave to appeal had been made. He submitted, however, that even if an application for leave were made, leave should not be granted. It was said that there was no sufficient doubt in the correctness of O'Bryan J.'s judgment and in any event no substantial injustice would flow if leave were refused: see *Niemann v. Electronic Industries Ltd.* [1978] V.R. 431.

For the reasons which we have already given the order sought to be appealed from was an interlocutory order and Mr. Myers ultimately sought leave to appeal *nunc pro tunc* from that order if contrary to his primary submission the court concluded that leave was necessary.

It is, therefore, necessary to consider whether there is sufficient doubt that the judgment appealed from is correct. It was said that the judgment was a discretionary judgment and therefore the limitations upon a court of appeal's interfering with such a judgment had to be borne in mind.

Although the judgment is an interlocutory judgment it involves no substantial difficulty in law. The principle to be applied is clear and was indeed quoted by the learned judge from *McPherson on Company Liquidations*, 3rd ed. p. 209 where it is said: "The guiding principle in the appointment by the court of a liquidator is that he must be independent and must be seen to be independent." The authorities to which we were referred amply support that statement of principle and it is unnecessary to refer to them.

It seems clear that Mr. Humphris cannot be seen to be independent because he is a partner in Ernst & Whinney whose relationship with the company between 23 December 1988 and 17 March 1989 may require to be investigated by the liquidator. In the present circumstances that is sufficient. The statement that the relationship between the firm and the company may require to be investigated involves no finding of any impropriety on behalf of Mr. Humphris or on behalf of Ernst & Whinney, far less does it involve any finding of negligence or breach of duty. Those questions are simply not before us and there is not the slightest evidence before us to support any such allegations. But enough appears to show that the relationship between Ernst & Whinney and the company may require to be investigated and that is enough. Indeed Mr. Humphris conceded in cross-examination that he would expect that the liquidator would have to investigate the activities of his partners. The very fact of Mr. Humphris's having been provisional liquidator might be enough to suggest that he should not be appointed liquidator of the company. It is true that as provisional liquidator he will have acquired useful knowledge but it is necessary to weigh the benefit of that knowledge against the possibility that a conflict of interest and duty may arise: see *Re Stewden Nominees No. 4 Pty. Ltd.* (1975) 1 A.C.L.R. 185, at p. 188. Nothing here suggests that there will necessarily be such a conflict but the relationship between Ernst & Whinney and the company at a critical time and the purpose of the retainer of Ernst & Whinney is sufficient. The liquidator should not be put in a position where his independence might be open to challenge.

Mr. Chernov also says that even if there be sufficient doubt in the correctness of the primary judge's decision no substantial injustice will be suffered by the banks if leave to appeal is refused. Although the question of substantial injustice is an appropriate consideration in determining whether leave to appeal should be granted it is of much less significance in this case than in many others. It is of the greatest importance that there should be no possibility of criticism attaching to one of the court's own officers on the ground of a conflict of interest and duty but in any case there would be a substantial injustice to the creditors if the relationship between Ernst & Whinney and the company could not be fairly, promptly and independently investigated and be seen to be independently investigated.

For these reasons leave to appeal should be granted and the question then arises whether this court should interfere with the discretionary judgment of the primary judge. The principles upon which an appellate court interferes in such a judgment are well known and it is sufficient to refer to *Lovell v. Lovell* (1950) 81 C.L.R. 513, at p. 533 per Kitto J. The onus upon a party seeking to have an appellate court interfere is a heavy one but "a clear conclusion that the judge was plainly wrong" justifies the reversal of his decision.

In our opinion, the learned judge was here in error in holding that the conflict between Mr. Humphris's personal interest and his duty as liquidator

was more apparent than real. The conflict lies in the need of the liquidator to be seen to be independent of any matter which his duties as liquidator may require him to investigate. The learned judge erred in assuming that the principle of independence to which we have referred would not be offended if Mr. Humphris were appointed liquidator and suitably qualified professional persons independent of Ernst & Whinney investigated and reported to the committee of inspection. Further, his Honour appears to have given too much weight to the loss of Mr. Humphris's knowledge as provisional liquidator and insufficient weight to the necessity for it to appear that there is no conflict of duty and interest arising from the relationship of Mr. Humphris's firm with the company. The learned judge seemed to attach weight to the fact that there was only a possibility that Ernst & Whinney's professional work might have been carried out unskilfully and might have caused damage. It is indeed no more than a possibility but the point is that the liquidator must necessarily be free to investigate the relationship just as he would be able to investigate any other relationship between consultants to the company and the company.

Mr. Chernov submitted in the alternative that, if the court was disposed to accept the appellant's contentions, we should not disturb the appointment of Mr. Humphris as liquidator, but should appoint an additional liquidator whose task would be limited to investigating the position as between Ernst & Whinney and the company. There was some discussion about the scope of the powers which such a liquidator might be given but we need not discuss the proposal any further because we are clearly of the opinion that this is not an appropriate case in which to exercise the power to appoint a second liquidator for limited purposes. Our reasons may be briefly stated. First, the appointment of another liquidator in all the circumstances would be likely to make a complex liquidation even more so. Secondly, it would be likely to be more expensive to have two liquidators rather than one. Thirdly, it would be very difficult to investigate the company's relationship with Ernst & Whinney at the same time as the investigation of the company's affairs generally without one investigation impeding the other. Fourthly, we cannot be satisfied that the duties of a second liquidator would be so separate and distinct that they could be satisfactorily discharged without duplication of work and without recourse to the first liquidator for information on matters relevant to the duties of both liquidators.

For these reasons we shall allow the appeal and set aside the order appointing Mr. Humphris liquidator of the company.

Before parting with the case it may be desirable to state some at least of the reasons for treating this case as urgent. First, there are very large sums of money involved. Secondly, the liquidation is likely to be difficult and complex. Thirdly, the chief executive, one Friedrich, was stood down on 14 March in circumstances which led to very substantial public interest in the whole case. Further, there is a strong desire of the parties for a quick resolution of the matter and they have co-operated to make that a possibility.

Solicitors for the first appellant: *Baker & McKenzie.*

Solicitors for the second appellant: *Darvall McCutcheon.*

Solicitors for the liquidator: *Westgarth Middletons.*

Solicitors for the company: *Lilley Brereton.*

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