

TECHNICAL INSIGHTS

Issue 3 - 2017

Invalid appointment of administrators on grounds of improper motives of directors

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Introduction

The ease with which an insolvent company may appoint an administrator following the resolution of its board presents an opportunity for unscrupulous directors to take advantage of the administration procedure for extraneous and improper purposes.

Australian courts have often intervened to terminate a voluntary administration where the decision to appoint an administrator over an insolvent company has been actuated by directors for purposes other than in furtherance of the object of Part 5.3A, Corporations Act as formulated in section 435A. Termination of the voluntary administration in these circumstances will most often result in the company proceeding from administration into winding up under order of the court.

In dealing with such cases Australian courts have consistently employed the principle referred to in *Kazar v Duus* (1998) FCA 1378, namely:

“A statutory power must be exercised for the purpose for which it was conferred. If the power is exercised for more than one purpose, where one of those purposes is improper, the exercise of the power will be vitiated if the improper purpose was a substantial purpose in the sense that the decision would not have been made but for the ulterior purpose.”

Essentially, the principle is premised on causative effect. Where directors are found to have been motivated by an improper purpose that is causative in the sense that but for its presence their powers would not have been exercised, the tainted action is rendered invalid by the impermissible purpose.

Cases where improper motives of directors have resulted in termination of the administrator's appointment

The following list is compiled from cases where directors have been motivated to put their insolvent company into administration for purposes extraneous to those envisaged by the voluntary administration process:

- ▲ Installing an administrator who might be more compliant than the provisional liquidator already in office and with whom the directors were in dispute: *Aloridge v Christianos* (1994) FCA 972.
- ▲ Where a sole director appointed an administrator with a view to the adoption of a deed of company arrangement by a decision of creditors (being himself and two persons allied with him) of doubtful value, and which would have the desired effect of placing a stay on claims being litigated against the company: *Blacktown City Council v Macarthur Telecommunications Pty Ltd* (2003) NSWSC 883.

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- ▲ Where an administrator was appointed by a sole director in the face of a winding up application in order to manipulate the relation-back day to his own personal advantage: *St Leonards Property Pty Ltd v Ambridge Investments Pty Ltd* (2004) NSWSC 85.
- ▲ Appointment of administrator enabled directors through their control of the majority of creditors to avoid having their conduct of the affairs of the company scrutinized: In the matter of *Sales Express Pty Ltd (Administrators Appointed)*(2014) NSWSC 460.
- ▲ Appointment of administrator was inappropriately used as a means of resolving shareholders' dispute: *Cadwallader v Bajco* (2001) NSWSC 1193; see also *Re Keneally as administrator of Australian Blue Mountain International Cultural and Tourist Group Pty Ltd (Administrator Appointed)* (2015) NSWSC 937.
- ▲ Appointment of administrator for the predominant purpose of forestalling ASIC's application to wind up the company and to appoint a provisional liquidator: *ASIC v Planet Platinum Ltd* (2016) VSC 120.
- ▲ Where the appointment of the administrator was a defensive tactic used by directors knowing that they would be removed by shareholders on the following day: In the matter of *Condor Blanco Mines Ltd* (2016) NSWSC 1196.



At the time of their appointment, is the administrator under a duty to assess the validity of the appointment by inquiring into the purpose or motives of the directors?

The Court in *Condor Blanco Mines Ltd* (see above) has provided useful guidelines on this issue. They can be summarized as follows:

- ▲ In general, it is not part of the administrator's responsibility in assessing the validity of his or her appointment to delve into any purpose or motive of the directors beyond that of ensuring that the directors have resorted to administration in response to actual or impending insolvency of their company. In this last respect, the administrator's duty of enquiry extends to ensuring that directors genuinely hold the requisite opinion concerning insolvency and have validly and regularly passed a resolution in terms of section 436A, Corporations Act.
- ▲ In exceptional cases where without any form of enquiry it is apparent to the administrator that the directors were resorting to administration for an extraneous purpose e.g. because they actually said so, or the improper purpose is patently obvious, the intended administrator is obliged not to accept the appointment.
- ▲ Where following appointment the administrator learns of the alleged improper or extraneous purpose of the directors in appointing him or her, it will be appropriate for the administrator to exercise the power to bring court proceedings or obtain directions as to the status of the appointment.
- ▲ In the event that legal proceedings involving allegations of improper purposes are brought by a person other than the administrator, e.g. a creditor or dissenting director, the administrator should adopt a position of neutrality and assist the court in the progression of the proceedings

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Can an administrator's appointment be valid notwithstanding the improper purpose of the appointing directors?

The underlying concern raised by this question is whether improper purposes of directors should be allowed to frustrate cases where the statutory objectives of administration are likely to be achieved, notwithstanding the improper motives behind the appointment and their causal effect.

Recently this issue has received the attention of UK courts with respect to that jurisdiction's administration procedure. Their approach has revealed a reluctance to allow directors' motivation and conduct to obstruct the administration process where there are reasonable grounds to expect that the statutory objectives of administration remained achievable.

In the most recent UK case on this issue, *Thomas v Frogmore Real Estate Partners GPI Ltd* (2017) EWHC 25 the Court observed that even if it is established that the appointor had an improper motive, the achievement of the statutory purpose of administration "would normally be the main touchstone for the court." If the statutory purpose is likely to be achieved then the appointor's motive "may become of relative insignificance in such circumstances."

The approach of the UK courts is to give priority to the likely achievement of the statutory purposes of administration and ensure that the appointor's improper motives are only likely to result in the termination of administration in the most extreme cases of director abuse of process.

For Australian purposes this approach has much to commend it and could readily be achieved by an administrator applying under section 447C, Corporations Act for an order declaring his or her appointment to be valid and in accordance with the object and spirit of Part 5.3A, Corporations Act notwithstanding the improper purposes of the appointing directors.

Concluding comments

Australian courts have demonstrated a willingness to terminate a voluntary administration where it has been found that directors have been motivated by

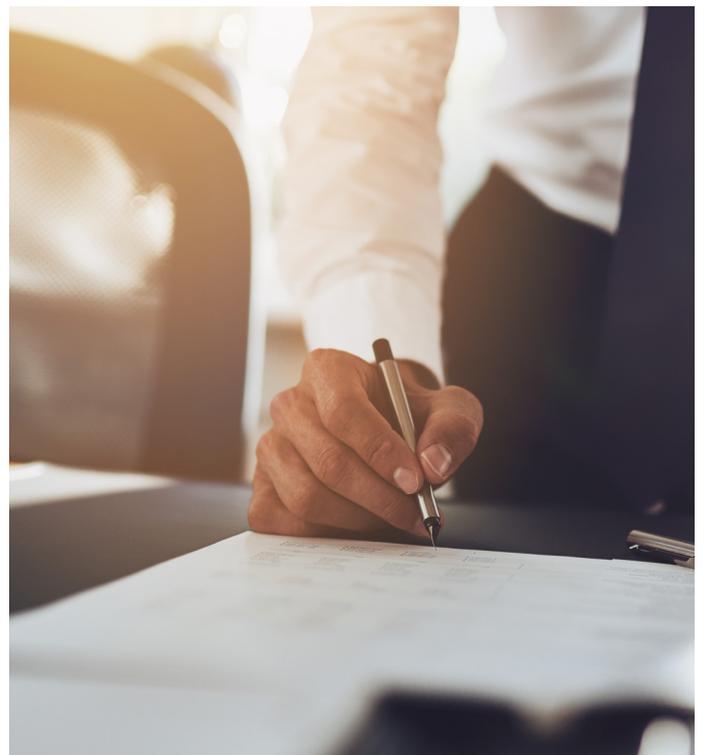
an improper purpose, "in the sense that the decision would not have been made but for the ulterior purpose": *Kazar v Duus* (see above).

We have seen that UK developments on this issue have become more focused on whether the statutory purpose of administration is likely to be achieved irrespective of the directors' improper motivation behind the administrator's appointment.

This approach has much to commend it, and essentially gives priority and effect to the statutory objectives of the administration process as formulated in section 435A, Corporations Act. In allowing the objectives of the administration process to prevail, the improper or ulterior motives of directors will be treated as being of "relative insignificance" except in the most extreme cases of abuse of process being in complete disharmony with the objectives of the voluntary administration process.

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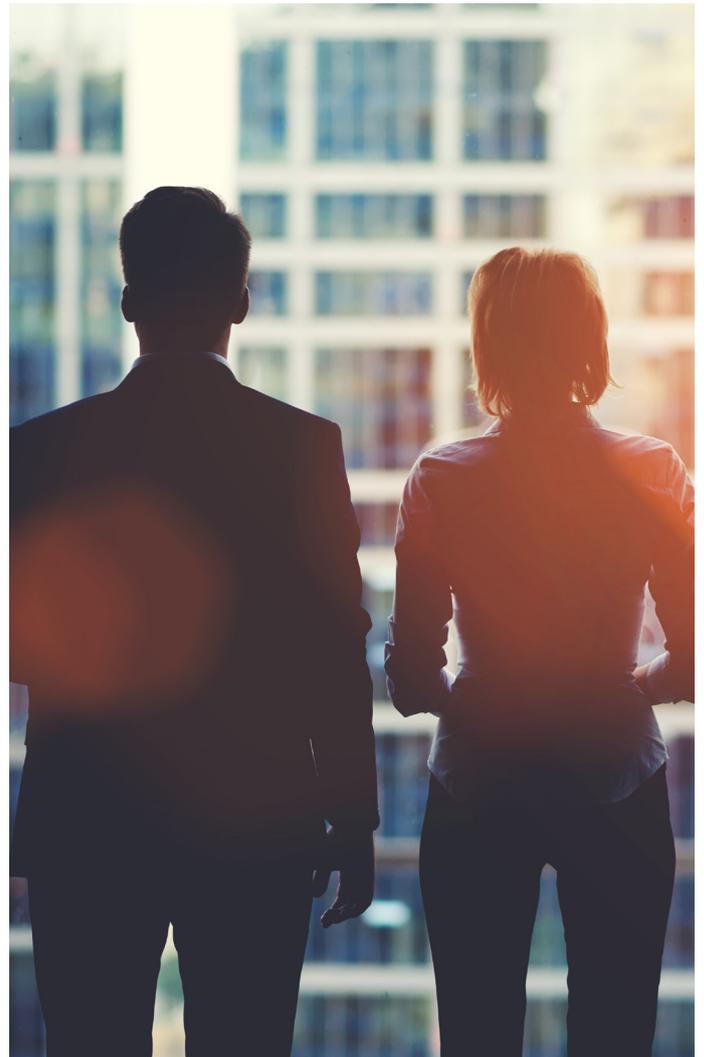
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