SQUIRE PATTON BOGGS

Standing to Challenge

Courts Likely to Continue Assisting Stakeholders

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External administrators often occupy quasi-judicial offices which, among other things, require them to:

- Assess and adjudicate on competing interests
- Take coercive and enforcement actions, including by conducting, reporting on, and acting upon, sensitive investigations
- Exercise commercial and legal judgments, often in contentious and time sensitive circumstances
- Engage with the market, the courts, regulators, and stakeholders

They must do all this while maintaining objectivity and discharging their own legal obligations. That description paints a relatively complex picture of the challenges faced by external administrators. However, the reality is their positions and the challenges they face are often far more complex and fraught for various reasons, including, but not limited to, the fact that restructuring and insolvency laws:

- **Do not operate in a vacuum** – There are often, and for good public policy and other reasons, major intersections with industrial relations, corporate governance, securities, market regulatory, sector regulatory, corporate (and often criminal) misconduct, tax and duties, competition and consumer, cross-border, public governance, privacy, financial services, court oversight laws and regulations.
- **Are subject to regular judicial reviews, law reform, inquiries, and cross-border influences –** This is particularly so, but not limited to, where significant changes in economic cycles are forecast or in motion, because of a change in government or significant changes in government policy, or where sector or market specific inquiries or regulatory changes are proposed.[1]
- **Often include inherent uncertainties** – They are more conducive than other branches of corporate law to being interpreted, applied and enforced in novel and ever-changing ways, largely because practitioners and transaction proponents strive to identify new ways to preserve, realise or transfer value. Equally, they are more prone to judicial and stakeholder activism, particularly where competing (or unrecognised) interests are in question.

If current forecasts prove to be true,[2] the challenges faced by external administrators in terms of discharging their legal obligations will likely intensify in complexity, timing and scope. In that context, it is likely that governments, regulators, and the courts charged with oversight of external administrators will be closely monitoring how their legal (and commercial) obligations are discharged and, more importantly, the impacts of their decisions on the competing interests of stakeholders. Although external administrators might not be trustees[3], they often take possession of assets to which the claims of third parties attach, and where they are empowered to:

- Realise assets (or value) for the benefit of third parties
- Consider (and adjudicate on) the competing interests of third parties

The liquidators in *Hastie* argued (unsuccessfully) that they were trustees. External administrators (and those supporting the types of claims brought in *Hastie*) will assess the implications of Justice Middleton's decision in their own ways. What is clear is that if the trustee argument had been accepted, the commercial and legal judgment calls of external administrators would have likely come under even more scrutiny than what is presently the case. The commercial, financial, and legal landscape is presently such that there is obvious distress in the market. The MPC Report issued last week observed that:

> "Business investment is expected to be very subdued in the near term, consistent with elevated levels of financial market volatility, real-economy indicators of uncertainty (Section 2.3) and the latest intelligence from the Bank's Agents. The weakness in UK demand growth over the projection also reflects the slowing in the world economy, although the global activity outlook is broadly unchanged compared with August. Since the previous Report, other European governments have announced a range of policy measures to address the impact of high energy prices for households and businesses, which is supporting the euro-area growth outlook. Tighter financial conditions and a slowing housing market are expected to weigh on growth in the US, however. In China, weakness in the property market is also expected to continue to depress growth, while the Chinese authorities' zero-Covid policy could continue to constrain activity.
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> "High energy, food and other bills are hitting people hard. Households have less to spend on other things. This has meant that the size of the UK economy has started to fall." [4]

1 See, for example, the changes in the financial services sector in Australia following The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, established on 14 December 2017, and the final report, tabled in the Australian Parliament on 4 February 2019. Alternatively, the more recent review announced by the UK Insolvency Service (on 7 July 2022) on the proposed implementation of the latest elements of the UNCITRAL's Model Law on the Recognition and Enforcement of Insolvency-related Judgments and the potential implications for the rule in *Gibbs*.

2 See, for example, The Bank of England Monetary Policy Report published on 3 November 2022 (MPC Report).

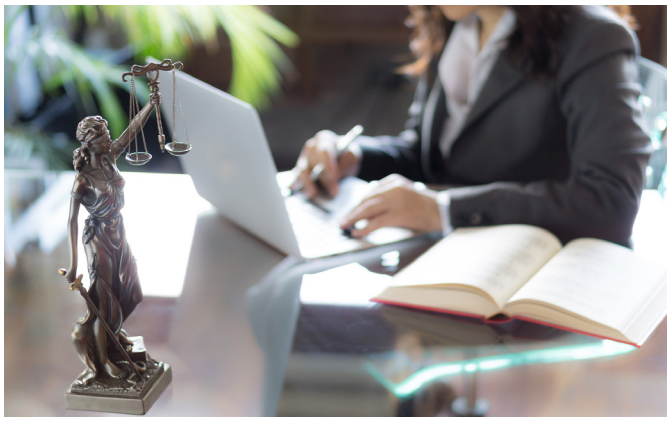
3 See *Hastie Group Ltd. (In Liq) v. Multiplex Constructions (Formerly Brookfield Multiplex Constructions Pty Ltd) (No. 3) [2002] FCA 1280 (Hastie No. 3), [159] (Hastie)*.

4 MPC Report, 1.2, 2.3.

Economic downturns and corporate renewal processes are an inherent part of free market economies. Distress to some represents opportunities for others, including in terms of investments and recapitalisations. External administrators have an important role to play in those contexts. Above all else, they ought to bear in mind their commercial and legal obligations, and the fact that markets, governments, courts and their stakeholders are looking at them to act reasonably and responsibly both in advance of, during and after any downturn. The PMC Report regrettably paints a bleak picture. The reference to "people being hit hard" is calculated. It is not only intended to alert governments to the need to recalibrate fiscal policies, but is also intended to warn and prepare others in financial markets. Judges with oversight of external administrators will (and already do) take judicial notice of market and economic conditions. Those factors will be relevant in their assessment of the conduct of external administrators, particularly in relation to the competing interests or unrecognised interests of stakeholders.

In the recent past, various key judicial developments in Australia and abroad have informed how governments, regulators and the courts might assess the decisions (and conduct) of external administrators in the short- to mid-term. Those developments include, but are not limited to, the following:

- The Australian federal government has announced a comprehensive review of the effectiveness of Australia's corporate insolvency regime.[5] In particular, the review is focused on how the regime presently protects and maximises value for the benefit of all stakeholders and the economy. The review, which is seeking submission by 30 November 2022, intends to report to both houses of Parliament by 30 May 2023. That timing roughly coincides with the timing of the next (proper) federal budget, where it is almost inevitable that the government will have to introduce fiscal, structural, and legislative measures to try and buffer the Australian economy for the type and extent of pain outlined in the MPC Report.



- The UK Supreme Court decision in *BTI v. Sequana*[6] confirmed the existence of a duty owed to the company by its directors to consider the interests of the company's creditors in the twilight zone of solvency. New Zealand laws regarding the duties of directors when facing insolvency have also recently been examined. The Court of Appeal has called for Parliament to review New Zealand's statutory insolvent trading regime in line with domestic and foreign developments, including in Australia and the United Kingdom.[7] In Australia, those laws (and duties) have been the subject of judicial consideration and debate for some time.[8] The courts will have regard to both domestic and foreign developments in considering the existence and enforcement of the duties. That ultimately means there will be implications not only for company directors, who are the primary target of the duties, but also the financial, legal, and restructuring advisers (including external administrators) who may be advising boards or directors in the twilight zone regardless of whether they ultimately seek to take on formal roles after an appointment date.
- The Victorian Supreme Court decision in *Barokes*[9], which approved a foreign creditor bringing a derivative action in the name of the company of which it is a creditor, against its current liquidators, for failing to have sufficient regard to its offers in the context of contested transactions and extensive financial support. In greenlighting the derivative action, the court determined that it could involve its inherent jurisdiction to grant leave to any "appropriate person" to bring proceedings on behalf of a company in liquidation, even if the subject of the litigation is the very the liquidators in control of the estate. The court was not concerned by, firstly, the fact that the creditor seeking to bring the derivative action was a foreign entity; secondly, that it stood to potentially gain from any satellite litigation against the liquidators; and, thirdly, that the litigation would likely delay distributions to creditors from realisations already made. The significance of the decision cannot be understated in the prevailing economic circumstances. It clearly opens the door for a broad class of stakeholders to act against liquidators if they can establish that they have meritorious claims.
- The UK Supreme Court's pending decision in *Chedington Court Estate10,* on whether a bankrupt has standing under s 303(1) of the Insolvency Act to challenge transactions entered by their trustees, when the relief sought would have no impact on their position within the bankruptcy. That section permits a trustee's exercise of discretion to be challenged on the application of "dissatisfied persons". If the Supreme Court dismisses the appeal by the trustees, it has the potential to result in an increase in applications under s 303 to challenge or review decisions at time when the MPC says that people are being "hit hard".

5 On 28 September 2022, the Parliamentary Joint Committee on Corporations and Financial Services began an inquiry into corporate insolvency in Australia.
6 *BTI 2014 LLC v. Sequana SA and others [2022] UKSC 25.*
7 See, *Yan v. Mainzeal Property and Construction Ltd (in liq) [2021] NZCA 99.*
8 See, for example, *Westpac Banking Corporation v. Bell Group Ltd (in liq) [No 3] [2012] WASCA 157* and related decisions.
9 *Barokes Pty Ltd (in liq) [2022] VSC 642 (Barokes).*
10 In the matter of *Nihal Mohammed Kamal Brake and Andrew Young Brake UKSC Claim No. UKSC 2021/0010 (Chedington Court Estate).*

- The judgment of Justice Abdullah in the High Court of Singapore in *Midas Holdings11* in which His Honour determined that s 285 of the local Companies Act – which allows liquidators to obtain information on a company's affairs – has extraterritorial effect, including as against former foreign auditing, financial or restructuring advisers of externally administered entities. The liquidators had obtained litigation funding and sought to act against the former corporate advisers but required disclosure to assess the basis upon which they might proceed. The advisers resisted disclosure primarily on the basis that the s 285 had no exterritorial effect, but that argument was rejected. His Honour determined that "limiting the operation of s 285 to material and persons within the territory [would] hamper the proper operation of liquidation[s], whereby a liquidator's investigation into a company would be easily thwarted by the person removing himself from the jurisdiction".[12] His Honour was also satisfied that "just because the liquidator had obtained funding and filed [a] writ did not mean that he has everything required to pursue the [identified] claims".[13]
- The judgment in *Atlas Equifin14,* where an application for a winding up order was opposed by a shareholder of the company sought to be wound up, and, was upheld by Judicial Commissioner Goh Yihan. In granting the shareholder standing to oppose the winding up application, the court had regard to various factors, including whether a "substantial interest" was established. It determined that "a requirement for leave [to be heard] can coexist consistently and is coterminous with the notion that a shareholder/contributory has the legal standing to be heard."[15]

A Diverse Range of Stakeholders

Stakeholders are not easily identifiable. Alternatively, once identified, recognising, and paying sufficient legal, commercial, and financial regard to their unique (and often competing) interests may prove difficult for external administrators.

Whether "aggrieved persons", "interested persons", "appropriate persons" or "dissatisfied persons", domestic and foreign restructuring regimes have, and will continue to, cast wide nets in hearing from, and giving standing to, entities who wish to challenge or judicially review either the decisions made by external administrators, or their conduct. That trend will likely gather pace as the recent developments outlined above (amongst others) filter through in terms of their impacts on legislative reform and judicial oversight of insolvent estates. In that context, external administrators must recognise the expanding nature of their duties (and corresponding liabilities both pre- and post-appointment) in seeing through their transactions, adjudications and claims. External administrators need to act cautiously before embarking upon claims (irrespective of internal or external funding arrangements) or concluding contentious transactions.

In respect of claims, the risk profiles for external administrators, in the context of both types of funding, are different, and requires the assessment of unique metrics and threshold questions – both of law and commerce. Those assessments are far more complex than simply identifying a potential claim, assessing its merits, seeking or securing funding, and embarking on litigation. Recourse to court processes and invoking the coercive powers of a court are avenues routinely available and familiar to external administrators, but just because those avenues exist, and a legal and commercial basis might be present to take coercive, recovery or enforcement action, does not mean that the first step need always be litigation. Indeed, taking that approach naturally invites scrutiny, not limited to that from the court (which occupies an oversight function in any event), but from a very broad (and sometimes unknown) range of stakeholders and regulators, including from overseas. Proponents of claims would also be best served pausing to critically assess the implications of their support for external administrators by paying regard to the current economic, legislative and judicial contexts relevant to insolvent estates.

In respect of transactions, exercising expeditious legal and commercial judgment calls will always be part of the mandate of external administrators. However, the need to act decisively and quickly should not come at the cost of not properly discharging one's duties. That is particularly so in circumstances where, firstly, competing transactional interests are at play and, secondly, where creditors are looking to administrators for robust and well-reasoned rationales for why one transactional path should be favoured over another.

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11 *Xu Wei Dong v. Midas Holdings Ltd [2022] SGHC 268 (Midas Holdings).*
12 Ibid, [34].
13 Ibid, [45].
14 *Atlas Equifin Pte Ltd v. Electronic Cash and Payment Solutions (S) Pte Ltd and others [2022] SGHC 258 (Atlas Equifin).*
15 Ibid, [34].