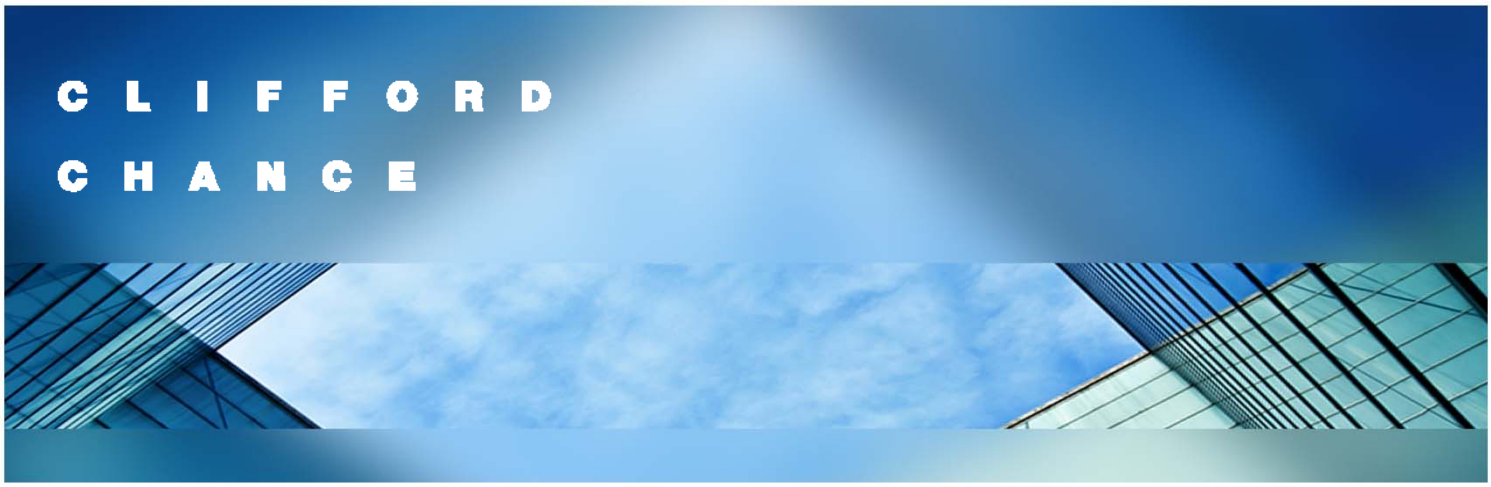

HEIGHTENED RISKS FOR LIQUIDATORS IN INVESTIGATING AND PROSECUTING POTENTIAL CLAIMS

When investigating potential claims against third parties for the purpose of enlarging the pool of funds available for distribution to creditors, prior to the commencement of proceedings, it is incumbent upon liquidators to satisfy themselves that these claims have reasonable prospects of success. However, whilst appreciating the extent of the due diligence required is often extensive (including, in many cases, the seeking of independent legal and/or expert advice, as well as litigation funding), liquidators must ensure that they do not act in a dilatory fashion in investigating and prosecuting potential claims. Delay may have disastrous consequences, including, as recent litigation in the Supreme Court of New South Wales has demonstrated, the dismissal of proceedings in a summary fashion at the interlocutory phase.

Key issues

- The Supreme Court of New South Wales has dismissed on discretionary grounds claims maintained by the liquidators of a collapsed construction industry giant against its former auditor at the interlocutory phase of the dispute.
- Courts will not take kindly to parties acting in a dilatory fashion in investigating and prosecuting claims, not least due to the resultant prejudice occasioned upon potential defendants.
- Echoing a trend appearing in the context of class actions, parties should expect greater scrutiny by the courts of the likely beneficiaries to litigation, potentially including third parties (such as litigation funders and lawyers).

THE FACTS

Throughout 2014 to 2016, the liquidators of the Australian arm of collapsed multinational construction giant, Hastie Group (**Hastie**), commenced a number of proceedings against Hastie's former auditor in the Supreme Court of New South Wales, in connection with Hastie's audited financials.

Relevantly, proceedings in respect of each of the 2007-08 and 2008-09 financial years were filed (but not served) on the eve of the expiry of the applicable limitation periods. Each originating process was valid for service for six months.[1] The liquidators approached the Court on an *ex parte* basis on three occasions seeking extensions of time for service of the originating processes; twice in respect of the 2007-08 audit claims, and once in respect of the 2008-09 audit claims. The proceedings were ultimately served on 3 June 2016, following which the auditor filed applications seeking to set aside service on the basis that the extensions should never have been granted.

At a hearing before Justice Ball in November 2016, his Honour was invited to re-exercise the relevant discretion by refusing to grant the extensions of time previously obtained by Hastie; the consequence of setting aside the extensions being that the originating processes would be rendered stale and the proceedings consequently statute-barred.

THE ISSUES BEFORE THE COURT

In *Hastie Group Limited (In Liquidation) v Moore* [2016] NSWSC 1682,[2] the primary question before Justice Ball was whether the extensions granted to

Hastie should have been given on the basis of the evidence before the Court at the time the extensions were sought (together with any new evidence tendered at the hearing *de novo*). The liquidators' evidence provided, amongst other things, that:

1. Delay in service could be attributed to:
    - the amount of material required to be reviewed when investigating potential claims and in assessing the prospects of the claims;
    - difficulties in obtaining litigation funding;
    - upon successful negotiations with a litigation funder, the need to satisfy certain conditions precedent to funding including:
        - conducting public examinations of former directors and officers; and
        - obtaining of favourable advice from senior counsel as to prospects.
2. Failure to grant the extension would result in the loss of an '*important potential avenue of recovery for the benefit of creditors*'. This was said to be because the liquidators would be put in a position where they would be required to effectively abandon the claim as a result of not being in a position to further investigate or properly particularise the pleading. In turn, this would result in the pleading being rendered liable to strike out and summary dismissal if served.

His Honour Justice Ball held that, on balance, the discretionary factors at play weighed against the extensions being granted for a number of reasons, including that the work for which the extensions were required could have been undertaken before the extensions became necessary. His Honour accepted the auditor would suffer prejudice if the extensions were granted and that the only creditors that would suffer prejudice as a consequence of dismissing the proceedings was a syndicate of banks that had expressed little or no interest in funding, or playing any role in, the litigation.

Accordingly, his Honour set aside the extensions and dismissed, with costs, the proceedings in respect of the 2007-08 and 2008-09 audit claims.

ANOTHER AUDIT CLAIM DISAPPEARS

The liquidators thereafter focused on Hastie's 2009-10 and 2010-11 audit claims, which came to a head in *Hastie Group Ltd (in liq) v Bourne; Hastie Group Ltd (in liq) v Moore* [2017] NSWSC 709.[3] This was an application for leave to amend a pleading filed in August 2016 (the eve of a limitation period in the relation to the 2009-10 audit claim) where it was accepted by both parties that the pleading as filed was defective and liable to be struck out.

Justice Ward, Chief Judge in Equity, refused leave to amend the pleading in the form proposed by the liquidators, primarily on the basis that the proposed amended pleading (which had been prepared after the liquidators had taken a number of steps to obtain evidence, including, as noted above, by conducting public examinations) did not sufficiently set out, in material terms, the case which the auditor was required to meet. Her Honour noted that the Court will not grant leave to allow an amendment if it would be liable to be struck out had it appeared in the original pleading and stated (at [234]):

> *'In my opinion the criticisms made of the [proposed amended pleading] have considerable force and in broad terms should be accepted. Even though some of the complaints could in my opinion be adequately dealt*

with by the provision of particulars, the fundamental problem I see with [the proposed amended pleading] is the failure adequately to plead what it is that [the auditor] did, or failed to do, that amounted to a breach of [its] duties/obligations and the causal link between that breach and the losses claimed … against [the auditor]'

As a result of refusing leave to amend, her Honour was required to determine whether leave should be granted to the liquidators to attempt to replead their case or whether the proceedings should be dismissed.

The main factors relevant to her Honour's consideration of that question were:

- Delay by the plaintiffs in failing to properly plead a case, notwithstanding the obligation to promptly pursue a claim initiated on the eve of a limitation period (in addition to the standard obligations owed pursuant to the overriding purpose of civil litigation[4]);
- Presumptive prejudice to the individual defendants (i.e. the difficulty faced by witnesses in attempting to recall with accuracy events which occurred many years ago) and prejudice to the defendants as a whole (i.e. the auditor firm) in relation to the scope of the claims (which involved contracts entered into over ten years prior); and
- The fact that the only creditors which would likely benefit from the liquidators' pursuit of the claims would be the banking syndicate which had, in effect, disclaimed any interest in pursuing the proceedings.

Weighing against these considerations, the plaintiffs argued that they ought not be denied the right to prosecute the claims unless it was clearly demonstrated that there was no arguable cause of action. They also submitted that delay had been adequately explained.

Ultimately, Justice Ward refused leave to replead in respect of the 2009-10 audit claim, including on the basis that the liquidators had failed to demonstrate sufficient prejudice to creditors against a backdrop of successive failures to properly plead Hastie's case. Her Honour was minded to give the liquidators a further chance to replead in respect of the 2010-11 audit claim on the basis that the limitation period in respect of that claim had not yet expired.

TAKEAWAYS

It is clear that courts are placing increasing weight upon the obligations owed by participants in civil litigation to facilitate the just, quick and cheap resolution of disputes. In particular, that can be seen in the cases referred to above, where Hastie's liquidators' dilatory conduct in, respectively, bringing and prosecuting its claims against the auditor, as well as failing to properly plead Hastie's case, were significant reasons why those claims were dismissed.

The lesson to be learnt for liquidators is that potential claims must be swiftly identified, investigated, commenced and prosecuted, particularly if limitation periods are a relevant factor. In addition, the judgments discussed above reveal that courts will consider the beneficiaries to litigation, in an insolvency context, in exercising their discretion.

Clifford Chance acted for the auditor in these proceedings.

1 *Uniform Civil Procedure Rules 2005* (NSW) r 6.2(4)(a). Note that other jurisdictions have longer validity periods (see, e.g., *Supreme Court (General Civil Procedure Rules) 2015* (Vic) r 5.12(1)—one year).

2 https://www.caselaw.nsw.gov.au/decision/583cb69fe4b058596cba1ea3.

3 https://www.caselaw.nsw.gov.au/decision/5934dfb3e4b058596cba7431.

4 Relevantly, s 56 of the *Civil Procedure Act 2005* (NSW)—see also, e.g., Part 2.3 of the *Civil Procedure Act 2010* (Vic), section 37M of the *Federal Court of Australia Act 1976* (Cth), etc.

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