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Court Appointed Insolvency Referees Gain Further Momentum in Australia

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In the course of antecedent transaction proceedings, particularly for unfair preferences, arguably the most contentious and critical question to be determined is the date of insolvency. Although that question predominantly involves an accounting exercise, it also includes an assessment of the commercial, financial and trading realities of the relevant company and a consideration of legal principles.

Traditionally, courts have determined questions of insolvency either by reference to insolvency reports presented by the relevant external administrators seeking relief or with the assistance of an independent expert witness. In more recent times, courts have been issuing terms of reference to, and appointing, referees to consider and determine the question of insolvency. That trend has continued in Australia[1] and will likely gain further momentum as the economic fallout of the pandemic continues and the anticipated uptick in corporate insolvencies places further pressures on the judicial system.

The Court's Power and the Issue of Costs

Most courts have expansive powers to refer individual or collective questions of fact or law out to third-party referees for determination.[2] In doing so, the ultimate objective of the court is to streamline proceedings, while at the same time ensuring the just, cost-effective and efficient determination of claims. Unfortunately, in reality, references do not always lead to the outcomes (or benefits) anticipated by the litigants or courts who propose them. For starters, just because it is a third-party referee determining a critical question does not necessarily mean that the process will be any more efficient or cost-effective than if the court were to undertake its own assessment.

It is easy to see how costs might increase quickly when you consider the process of a reference. In short, one litigant (or the court) proposes a reference. If that proposal is not agreed then the question of a proposed reference itself becomes the subject of an interlocutory dispute. Then, once that is determined and assuming a reference is ordered, the parties are required to agree on, or propose, alternate referees. Although it is not uncommon for a court to determine the question of a suitable referee of its own volition, the litigants can still seek to compete in that process. In other words, even if the identity of the referee is determined by the court without necessarily hearing from the parties in open court, costs will likely still be incurred in the engagement and contest process including by, for example, competing submissions or objections being raised as to the opposing party's proposed referee(s).

The making of orders (or terms) of reference is not necessarily the end of the contest either. Arguably, the most contentious phases take place after the reference. That is, during the preparation, exchange and consideration of information (or evidence) by the referee and, in the process followed by, and ultimate decision of, the referee.

Litigants, particularly external administrators bringing antecedent transaction claims, should be conscious that although there are benefits to references, there are also downsides, including potentially increased costs.

Matters of Note

External administrators are accustomed to courts determining the question of insolvency. That generally occurs off the back of insolvency reports prepared by the applicant or an independent expert. However, court practices change over time and it is apparent that the Australian Federal Court in particular is embracing references as a means of determining key contentious issues well before trial. That raises the question of whether a party to a proceeding is entitled to a contentious matter of fact or law being determined by a judge alone. The answer is no. There is no such entitlement and any litigant approaching a proceeding on the basis that every fact or question of law in issue will, or must be, determined by a judge may be disappointed. Further, as pandemic-related disruptions continue and litigation (or insolvencies) increase, it is likely that references will gain further momentum and perhaps be embraced by other federal and state courts.

In cases arising from the same insolvency or in proceedings involving multiple parties, similar claims and a common contentious issue, courts will understandably seek to eliminate or contain the risk conflicting decisions by:

- Firstly, consolidating proceedings
- Secondly, seeking the consistent resolution of common questions by making a single referral

In circumstances where there are multiple related proceedings or multiple parties to a mothership proceeding, the court may determine that the best way to resolve the question of insolvency is through an investigative inquisitorial process undertaken by a referee rather than in a more traditional adversarial adjudicative process conducted by a judge at trial.[3]

1 See *Jahani (liquidator) v Commissioner of Taxation* [2020] FCA 1642; Weston in his capacity as liquidator of Starcom Group Pty Ltd (in liq) v Rajan [2019] FCA 1455
2 See, for example, s 54A of the Federal Court Act 1976 (Cth)
3 See *Jahani (liquidator) v Commissioner of Taxation* [2020] FCA 1642 at [26]

The New Normal

This year has introduced many a "new normal". It is likely that in 2021 the Australian Federal Court will continue to embrace referrals and shy away from determining questions of insolvency at trial or with the assistance of a single court-appointed expert witness who will be subject to cross-examination. This potential new normal presents both opportunities and challenges for different litigants. External administrators who think referrals will likely reduce their prosecution costs might be in for a surprise. The general (and expected) trend to date has been that the costs of a reference are split equally until such time as a matter is determined. In the past, external administrators were faced with the decision of taking the risk of relying on their own report in a proceeding or engaging an independent third-party expert to provide a report. Those options still exist. However, external administrators may also face the growing prospect of having a contest on a potential referral. Then, subject to a referral being made, engaging in the reference process and coming back to court to potentially argue about what can or should be adopted by the court.

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