Article Information

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Insolvency Newsflash – Focus on appropriate expenditure by practitioners continues

Courts have increased focus on the appropriateness of expenditure (including legal fees) incurred by insolvency practitioners and the steps they should undertake to determine if the costs and expenses are reasonable.

Re: Joe & Joe Developments Pty Ltd (subject to a Deed of Company Arrangement) [2014] NSWSC 1444

Recently, Courts have increased focus on the appropriateness of expenditure (including legal fees) incurred by insolvency practitioners and the steps they should undertake to determine if the costs and expenses are reasonable.

While the case of Joe & Joe was widely discussed in the industry, the more confrontational elements of the case including some serious allegations against the practitioners were determined in favour of the practitioners.

This case considers whether third party expenditure incurred by insolvency practitioners (including legal expenses and third party expenses) in the course of their appointment to a company were properly reviewed and considered by the practitioners. This article concentrates on those obligations, as addressed in the judgment.

Background

The appointment of the deed administrators to the Company originally came about as a result of a dispute between the two directors (Mr Elias and Mr Kossaifi) of *Joe & Joe Developments Pty Ltd (subjection to a Deed of Company Arrangement)* (the Company). The shareholders in the Company were the directors, and their respective families.

A Deed of Company Arrangement (DOCA) was executed, which included provisions for sale of certain properties, share buy backs and other, somewhat complex terms. Issues arose with respect to the operation and effect of the DOCA and the disputes between the two families continued. In hindsight, it is not unexpected that the appointment of Administrators did not resolve those disputes.

The Deed Administrators registered caveats, commenced proceedings seeking declarations that the families were in breach of the DOCA and an order terminating the DOCA (among other relief sought). Those proceedings were compromised. The Deed Administrators attributed the issues arising throughout the administration of the matter to the families being unable to act in a unified manner, with agreements vanishing as soon as they arise – if indeed they did in fact arise.

The Plaintiffs, Mr Elias and his family, being shareholders, sought a declaration that the Deed Administrators appointed to the Company managed the Company's affairs in a way that was prejudicial to the interests of the Plaintiffs and the Company's creditors and members. The Plaintiffs also made allegations that the Deed Administrators unreasonably:-

- incurred legal costs
- failed to have those costs assessed.

Consideration

The Court:-

- accepted that the Deed Administrators (then Administrators) were obliged to investigate the Company's business,

property, affairs and financial circumstances by reason of section 438A of the *Corporations Act 2001* (the Act) and in order to prepare a report to creditors pursuant to section 439A.
This was despite an email from the Plaintiffs' accountant to an employee of the Deed Administrators setting out that the directors of the Company did "not wish the receiver [sic] to spend further time investigating the company's affairs as any allegations of fraud or otherwise have been resolved…"

- accepted that where the parties and their legal advisers had been instrumental and involved in the drafting of the DOCA (which is the aspect of the case that seemed to attract the most attention), no proper complaint could be levelled at the Deed Administrators over the complexity or structure of the DOCA.
  Obviously, the creditors approved the DOCA and from a practitioners' viewpoint, to be criticised for the drafting and approval of a DOCA in those circumstances would have been most concerning.
- set out that the Deed Administrators' right to an indemnity with respect to legal fees arises, with respect to the administration, under section 443D of the Act, and, with respect to the deed administration, clause 12 of the DOCA which provided they were:
  "entitled to indemnity out of the funds that would otherwise be available to the creditors of the company for any costs, expenses and charges whatsoever incurred and this indemnity will operate as a priority over all other creditors claims and entitlements".
- followed some recent authorities including *AAA Financial Intelligence Ltd (in liq)* [2014] NSWSC 1270 (a decision which had been handed down after the case was heard, but before judgment) which held that: –
  - *"First, the liquidators (or trustees) must first decide to what extent they are bound to pay the liabilities they have incurred, and if they accept that they are bound to pay must do so, as they are personally liable. The second question is whether and to what extent they are entitled to recoup what they have paid from the estate."*
  - *"Although the Court will generally be supportive of liquidators who have incurred disbursements and paid them out of the estate in the exercise of their commercial judgment, albeit without the prior approval of the Court …the liquidators bear the onus of justifying their disbursements, and since they can only recoup from the estate if they have acted properly in instructing and paying third parties (such as solicitors), they should subject the bills received from them to critical scrutiny "*
  - *"Notwithstanding the Court's disposition to be supportive of liquidators who have incurred disbursements in the exercise of their commercial judgment, something more than the mere incurring and payment of a disbursement is required to justify it."*
- confirmed that in relation to the payment of legal representatives the key issue in the application was not the deed administrator's former solicitors conduct, but rather the conduct of the deed administrators in relation to the payment of the solicitors invoices.
- accepted that some amounts charged by the previous solicitors for the Deed Administrators warranted further enquiry by the Deed Administrators and pointed to occasions whereby simple emails were charged at a minimum of 2 units (12 minutes), and sometimes up to 4 (24 minutes). Further, there were minimal examples over the course of the solicitors' involvement where a single unit (6 minutes) was charged for a task, with which the Plaintiffs took issue.
  The Deed Administrators' evidence did not show that they or their staff had fully examined the invoices or the reasonableness of the time taken to perform certain tasks.
  To that end, the Court found that for the purposes of section 447E of the Act, the Deed Administrators managed the Company's business in a way that was prejudicial to the interests of creditors or members, or made an omission that is prejudicial, by failing to undertake appropriate review of the invoices from the former solicitors.
- held that the Deed Administrators should be allowed a further opportunity to lead evidence to justify legal costs paid and, to the extent that those costs are not justified by evidence, be ordered to repay such costs to the Company (and be left to such rights as they have as against their former solicitors).
  The Court did not require that the Deed Administrators have their solicitors' fees taxed.
- found that the Deed Administrators should repay a payment of approximately $17,000 made to a third party which was considered unjustified – where it was unclear what work the third party had actually done (leaving the Deed Administrators to any rights against that third party).
- found that, where the deed administration seems close to completion, the preferable course would be not to remove the Deed Administrators (subject to a qualification regarding any potential conflict of interest and duty with respect to their indemnity for legal fees and expenses).

Points to take away

This case highlights the professional conduct expected of insolvency professionals, (in this case Administrators and Deed Administrators) in relation to the incurring and payment of expenses including to legal professionals acting on their behalf.

Here, the Court was concerned to have more evidence about the appropriateness of the fees charged by the Deed Administrators' former solicitors given some of the entries were, in some circumstances, higher than one might reasonably expect. The former solicitors were not a party to the proceeding and did not appear for the Deed Administrators at

trial. Accordingly, the focus of the matter was on the Deed Administrators' review and analysis of the invoices, and whether they ought to have paid those fees, without review and query.

There is of course a practical consequence of this. Reviewing invoices would incur further professional fees of the Deed Administrators' staff with larger invoices requiring a more detailed and in depth review. Clearly, a balance must be struck between the amount of the invoices and the detail and depth of review.

The case also reinforces the importance for legal professionals acting on behalf of insolvency professionals to exercise due care and skill in rendering invoices, and ensuring their legal fees are proportionate and appropriate given the work conducted.