The judge, jury and executioner: a Trustee's capacity to adjudicate proofs of debt for legal fees

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By Jodie Rodrigues, Solicitor at Matthews Folbigg in the Insolvency, Restructuring and Debt Recovery Group.

Pursuant to s 102 of the *Bankruptcy Act 1966* (Cth), a trustee is required to "examine each proof of debt and the grounds of the debt sought to be proved".

Legal costs can often be a problematic consideration, when questions of assessment, and the nature of the costs claim are taken into account. It is therefore important to have regard to the type of costs claims (for instance those of the bankrupt's own solicitors, or adverse costs orders against the bankrupt). It is also relevant to consider at what stage in any costs assessment process the question of costs is being considered.

Case Study*: Kent and Orlizki, in the matter of the Bankrupt Estate of Milovan Stankovic* [2012] FCA 333

In this matter, the Bankrupt became bankrupt on 12 May 2009, but had lodged an application for extension of time to appeal from the sequestration order. This application was pending when in 2012 a hearing was held in regard to the proof of debt of the Bankrupt's former solicitors. This highlights the often precarious and always difficult position of trustees in the face of appeals and applications for review of sequestration orders which might have the effect of

entirely removing their authority to deal with the Bankrupt's estate and affairs, sometimes years after their appointment (as in this case).

In this case the Bankrupt had prior to bankruptcy instructed Kent Attorneys who submitted a proof of debt claiming that the Bankrupt owed $246,677 in legal fees ("**the Proof of Debt**"). This related to work done for the Bankrupt in 2008, in 4 separate sets of proceedings, prior to bankruptcy.

After his bankruptcy the Bankrupt filed 2 applications for costs assessment with the Supreme Court. This is notwithstanding that:

- the Bankrupt had included Kent Attorneys as a creditor in his Statement of Affairs for $246,000; and
- at the time of the bankruptcy, the time for the Bankrupt to seek an assessment of his legal costs (under the relevant NSW costs review legislation) had expired.

Both the Trustee and the Creditor wrote to the Supreme Court opposing the Court proceeding with the assessments, the Trustee doing so on the basis that it was his role to consider the proof of debt in the administration of the Bankrupt's estate.

Ultimately the Trustee admitted the solicitors in the amount of $189,624 and rejected the balance of $59,053. The basis for the rejection is not entirely clear from the judgment.

In any event Kent Attorneys commenced proceedings against the Trustee under s 104 of the *Bankruptcy Act 1966* (Cth) to seek a review of the Trustee's determination.

Importantly the Court considered that once the time for review under the statutory legislation had expired, "the fees, assuming compliance with the Legal Profession Act, must be regarded as a debt owing by the client to the solicitors." (at [12]) This meant that the Trustee's role in considering the Proof of Debt involved a different assessment.

The Court considered that where there had been compliance with the Legal Profession Act the Trustee then needs to:

- assess the prospects of success if the legal fees were referred to the Supreme Court for costs assessment; and
- if the bankrupt is out of time for such an assessment (as was the case here) the Trustee needs to assess the prospects of an extension of time being granted, to file an application for costs assessment.

In the present case the Trustee had not considered the Proof of Debt in light of these considerations. The Court found the Trustee had undertaken a review of the Proof of Debt, "standing in the shoes of the Supreme Court, on the basis that an application had been made for review". However, the Court found that where there was no assessment of the prospects of obtaining an extension of time to lodge an application for assessment, the Trustee should have admitted the Proof of Debt in full.

Outcome

It should be noted that different costs claims (for instance adverse costs) give rise to different costs considerations and issues. Further, each case should be considered in light of its own facts and circumstances and other clams and issues may also be relevant.

Nevertheless this case emphasises two important considerations for trustees when making determinations about legal fees:

1. **Where a bankrupt's own legal costs are concerned the role for the Trustee is not to consider the underlying costs directly, but rather whether the Supreme Court would reduce the costs on assessment. Sometimes this distinction may not necessarily be significant;**
2. **However where the time for applying for assessment of the Bankrupt's costs has expired the Trustee will need to give careful consideration to whether or not there would be any entitlement to apply for any extension of time to apply for assessment before seeking to reduce the full amount of the solicitor's outstanding costs claim.**

Read the case here.

Matthews Folbigg Lawyers has a specialist team dedicated to Insolvency, Restructuring and Debt Recovery. If you would like more information or advice in relation to Insolvency, Restructuring or Debt Recovery practice and procedure, please contact Stephen Mullette or Jeffrey Brown on (02) 9806 7459 or (02) 9806 7446,or email stephenm@matthewsfolbigg.com.au or jeffreyb@matthewsfolbigg.com.au.