



**SMITH HANCOCK**

# INSOLVENCY NEWSLETTER

February 2009

## **PROFESSIONAL FEES AND UNFAIR PREFERENCE CLAIMS**

The increased hardship being confronted by many businesses due to the recent volatility in the financial sector, the deteriorating economic conditions and falling consumer confidence has driven many businesses across a broad spectrum to seek professional advice from accountants and solicitors to assist companies in difficult times. In some instances, there may be little alternative for the accountant and/or solicitor to refer the client to an insolvency practitioner to perhaps review and/or restructure the business or facilitate the winding up of the company where it proves to be insolvent or is likely to become insolvent in the near future.

When a company goes into liquidation, the Liquidator has broad-ranging powers to deal with the business of the company. The Liquidator will realise the assets of the company and distribute the proceeds in accordance with the order of priorities set out in Section 556 of the Corporations Act, 2001 ("the Act") and the company's constitution (if distributing to members).

A Liquidator has a duty to investigate and if warranted recover transactions entered into by the company that may be considered void.

An objective of the Act is to ensure that ordinary unsecured creditors are treated equally. The Act provides the platform which can invalidate transactions that have the effect of preferring one creditor over other creditors. The transactions that may be set aside by a Liquidator are referred to as voidable transactions. Voidable transactions include unfair preferences, uncommercial transactions, unfair loans and unreasonable director - related transactions. In this newsletter we focus on unfair preferences, particularly in relation to professional fees.

### **Unfair Preferences – Section 588FA of the Act**

An unfair preference is a transaction to which the creditor and the company are parties (even if someone else is a party to the transaction) and

the transaction results in the creditor receiving from the company in respect of an unsecured debt that the company owes to the creditor, more than the creditor would receive from the company in respect of the debt if the transaction were set aside and the creditor were to prove for the debt in the winding up of the company.

The word "transaction" is given a very broad meaning under Section 9 of the Act, and includes conveyance, charge, guarantee, payment, obligation, release, or loan and includes a transaction that has been completed or given effect to or that has been terminated. For the purposes of the law of preferences, the transaction occurs not just when a sale or contract is made but when payment is made, which can often be many months down the track.

A Liquidator can recover an unfair preference from the creditor if the transaction occurred in the period six (6) months prior to the company going into liquidation. A Liquidator has three (3) years to file his application in the Court to recover the unfair preference.

Professionals including accountants and solicitors are vulnerable to Liquidators of insolvent companies seeking to recover payments made within the six (6) months prior to the winding up where, in the opinion of the Liquidator, the accountant and/or solicitor has received an unfair preference.

Several Court decisions<sup>1</sup> have dealt with the issue of when payments to professionals for services (past and/or future eg, funds held in Trust Accounts) may be considered to be an unfair preference within the scope of Section 588FA of the Act.

In order to avoid the prospect of a Liquidator

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1 Higgins v GS Enterprises Pty Ltd (In Liquidation) (1989) 7 ACLC

VR Dye & Co v Peninsula Hotels Pty Ltd (In Liquidation) (1998) 28 ACSR

Beveridge v Whitton (2001) NSWCA 6

Airservices Australia v Ferrier (1996) 185 CLR 483; 70 ALJR 655.

successfully attacking professional fees as unfair preferences, the following points should be considered:

1) Legal practitioners should enter into agreements with their clients providing for advance payments to be deposited in trust with express permission for the money to be withdrawn after the professional services have been provided. This should reduce the risk of prepayments being subsequently attacked as preferential payments as well as ensuring compliance with the Legal Practitioners Act.

2) Retrospective ratification of a payment from monies held in trust cannot result in there being inferred the type of agreement outlined in point 1 above.

3) Accountants are not as strictly regulated in respect of monies paid into trust accounts but it is recommended that similar procedures to legal practitioners be applied (i.e. payment in advance to the practitioner's trust account for services to be rendered).

4) If the sole purpose of the payment is to discharge an existing debt, the effect of the payment is to give the creditor a preference over the other creditors. Should the payment be a form of inducement to the creditor to provide future services as well as discharge an existing debt, the payment may not be a preference, unless it is for greater value than the services provided<sup>2</sup>. Clearly, this is a grey area.

### Conclusion

Professional service providers need to be prudent in their dealings with clients who they consider to be at risk of insolvency. They need to ensure payments for services rendered are made in accordance with relevant statutes and professional guidelines. Ideally, funds should be paid upfront and into a trust account – effectively a C.O.D. style arrangement.

## New Director– John Dickie

We are pleased to advise that John Dickie has joined Smith Hancock as of 19 January 2009 as a Director.

John has had extensive experience in the SME sector including the provision of Business Valuations, Due Diligence and General Litigation support services to

2 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 502; 70 ALJR 655.

a variety of businesses. At Smith Hancock, John will continue to provide these specialist services as well as insolvency services.

Prior to joining us, John was a partner in a large suburban firm of Chartered Accountants.

## Services Offered by Smith Hancock

Smith Hancock is a specialist Chartered Accounting practice, focusing on corporate reconstruction and insolvency.

In addition to the traditional formal insolvency appointments such as Voluntary Administrations, Receiverships and Liquidations, we undertake cost cutting reviews, business reconstruction advice, investigating accountants reports, partnership/shareholder disputes, plus many other related services.

Please telephone or email us if you have a matter in which you consider we may be able to assist.

## Electronic Newsletters

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## SMITH HANCOCK

Level 4, 88 Phillip Street  
Parramatta NSW 2150  
Telephone 02 8844 8866  
Facsimile 02 9689 2888

Email: [shs@smithhancock.com.au](mailto:shs@smithhancock.com.au)

Web: [www.smithhancock.com.au](http://www.smithhancock.com.au)



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