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Litigation funding in British Virgin Islands liquidations: practical guidance for liquidators

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Currently, the British Virgin Islands has no legislative framework for regulating third party litigation funding. Until recently, the absence of such a framework led many to believe that the rules against maintenance and champerty still operated so as in practice to prevent litigants from raising funds from third parties to prosecute or to defend claims. In *Crumpler v Exential Investments Inc* (BVIHC(COM) 2020/0081; 29 September 2020) Jack J clarified that third party funding arrangements were enforceable in the BVI.

While precedent in this area is limited, it appears that not all litigation funding will necessarily be permitted. There is no longer any statutory impediment to third party litigation funding, but the court still appears to have a residual responsibility for preventing the self-interested encouragement of lawsuits. Accordingly, litigation funding must be responsible, which is to say that it must not cede control of the prosecution of a cause of action to the funder, and the funder must be able to fund adverse costs to the amount it is funding the action itself. (See *Leremeieva v Estera Corporate Services (BVI) Ltd* (BVIHCM 2017/0118; 4 April 2019).)

In the context of a liquidation, whether it is solvent or insolvent, a liquidator may need to consider sourcing funding for litigation. This article looks at the options liquidators have in such situations, how those options are to be considered in view of liquidators' duties under BVI law, and what practical steps a liquidator can take to protect their position.

Fiduciary Duties

Liquidators are unique creatures of statute. They are in many ways like a trustee for the body of creditors (though no property vests in them). They are officers of the court where they are appointed under the Insolvency Act, 2003 but not so when appointed under the Business Companies Act, 2004. Both Business Companies Act and Insolvency Act liquidators are agents of the company, even though a liquidator controls their principal. Despite the difficulty in categorising liquidators, it is well established that they owe fiduciary duties to the company and to the body of creditors. In the context of a liquidation, a liquidator's fiduciary duties, whether as a Business Companies Act or Insolvency Act liquidator, include the duty to act in good faith and reasonably, and in the best interests of the company and the company's creditors as a whole.

Duty of care to creditors

A liquidator is expected to exercise their own independent judgment and to use their knowledge and experience in making commercial and administrative decisions. However, if a liquidator decides to sell an asset of the company in liquidation, they owe a duty of care in relation to the timing and valuation of the transaction.

In *Brewer v Iqbal* [2019] BCC 746, the English High Court found an administrator to have been in breach of his duty of care by failing to take specialist advice from a person within the relevant (and highly specialised) industry in which the company operated, by:

- failing to obtain a proper valuation of the company's assets before their sale
- failing to bring those assets to market through appropriate advertising

Liquidators have wide discretion in exercising their powers, but *Brewer* is a strong reminder that the discretion afforded to liquidators is not limitless. Professional advice is not always necessary, but there will be circumstances where a failure to obtain such advice vitiates the liquidator's decision-making process.

Realising a cause of action

It would be a mistake to assume that all BVI liquidations operate in the same way. There are a number of ways in which a liquidator may be appointed over a company, and under different pieces of legislation. A liquidation might even transition from one form of liquidation to another during its lifetime. Therefore, careful consideration of a liquidator's precise status and powers should always be given before a liquidator embarks on litigation in the name of the company over which they are appointed.

In a compulsory liquidation under the Insolvency Act, the court order appointing a liquidator over a company will often stipulate that they must obtain court sanction before commencing, continuing, discontinuing, or defending any legal proceedings in the name and on behalf of the company. Such a stipulation, however, is not actually required by the Insolvency Act; it is in the discretion of the court to make sanction a requirement, though it is common practice. Liquidators appointed by the court must be careful, therefore, to review the order appointing them to determine what powers they have which require court sanction. It is not unknown for the order to omit the requirement for sanction before commencing legal proceedings.

Where a liquidator is required to obtain sanction before exercising a power, the decision to exercise that power is effectively surrendered to the court (see *Greenhaven Motors Limited* [1999] BCC 463 and *Phoenix Group Foundation v Jackson* (BVIHCMAP 2020/0019; 17 November 2020)). Accordingly, and as a matter of practice, the decision to pursue litigation, and the question of funding that litigation, will be matters for the court to determine in most compulsory liquidations.

Members of a company may also appoint a liquidator of the company. They may do so under the Insolvency Act if the relevant statutory requirements have been satisfied. Importantly, the company does not need to be insolvent for this form of liquidation to be initiated, but it should not be confused with a voluntary liquidation under the Business Companies Act. Since a liquidator appointed by the members under the Insolvency Act will not have been appointed by a court order but by a resolution of the members, they will not require court sanction to commence legal proceedings. Similarly, the powers of voluntary liquidators set out in section 207 of the Business Companies Act do not require the voluntary liquidator to seek court sanction before exercising any of those powers, including the power to bring proceedings. Liquidators in voluntary and members' liquidations should exercise independent judgment when deciding to pursue a claim and how to fund it.

In some circumstances a liquidation may even begin as a voluntary liquidation under the Business Companies Act, but the liquidator later discovers that the company is in fact insolvent. In those situations, the liquidator must then proceed to treat the insolvency as an insolvency under the Insolvency Act and the Insolvency Act will apply to that liquidation. Again, a liquidator in such a situation will not have been appointed by a court order requiring them to seek sanction before commencing litigation.

The options

If a liquidator is able to proceed without court sanction, they have a wide discretion as to what to do when they become aware that the company in liquidation has a cause of action against a third party, but that discretion is subject to careful scrutiny. The commercial judgment expected of a liquidator likely includes considering whether the prospective defendant has sufficient assets to meet any court judgment, or whether the amount of potential adverse costs outweighs the maximum possible return from pursuing a claim.

Whether the company has money to fund an action will be an important factor in the decision of the liquidator. If there are funds which the liquidator can use to pursue a claim, they may legitimately do so provided that they:

- are exercising proper commercial judgment
- consider whether they would hazard their own money in the same way
- keep the costs under review to ensure that those costs can be justified to the court

Doing Nothing

A liquidator might simply decide that pursuing a claim makes little or no financial sense, either from a legal risk perspective or from an analysis of the maximum possible recovery versus a realistic estimate of outlay. Having said that, no matter what analysis the liquidator has carried out, they must be alive to the risk that they will be failing in their fiduciary duties to the company and to its creditors if they have not made a reasoned and reasonable decision which is documented.

Where a liquidator has been appointed as a voluntary liquidator under the Business Companies Act, or by members under the Insolvency Act, they must not accept without question the opinions of those who have appointed them. (See *Brewer v Iqbal* [2019] BCC 746.)

Assign the action outright

One view is that where there is a possible cause of action but the liquidator determines not to pursue the action on behalf of the liquidation estate, it might make sense for the liquidator to offer a full assignment of the action to a funder in return for a single payment. [1] Where a funder agrees, this will contribute to the assets of the company, but even where a funder cannot be found, the liquidator can show that they have attempted to realise an asset of the company (albeit without success).

The difficulty of this approach from a BVI perspective is that assignment under BVI law can only take effect in equity and not at law. [2] The effect of this is that the assignor must be joined to any proceedings brought by the assignee when pursuing an assigned cause of action. [3] This complexity, and the possibility that an equitable assignee might have to apply to restore the company to bring their claim, might greatly reduce the commercial value and attractiveness of this approach.

Ask creditors to fund action

Creditors are often the most obvious source of funding for litigation. Creditors are the intended beneficiaries of any recoveries made through pursuing possible causes of action, but that is not to say that creditors will always be keen to stake further money, especially where that litigation is being controlled by a liquidator, and not by them.

In theory, one might expect preferential creditors to explore litigation funding as a means of taking advantage of their preferred status. However, preferential claims in the BVI are limited to:

- unpaid employees (up to the value of US$10,000)
- sums due to the BVI Social Security Board (with specific limitations as to scope and amount)
- sums due to the Financial Services Commission (up to the value of US$20,000)
- any unpaid tax or licence fee or permit due to the BVI Government (up the value of US$50,000)

The commercial reality is that there is no realistic prospect of funding from these creditors.

The legislation in the BVI does not provide additional incentive for creditors who wish to fund insolvency litigation. Accordingly, creditors of BVI companies are left to balance risk and reward in the same way as other potential funders.

Self-funding

In some cases, a liquidator's firm will fund liquidation litigation itself. In more straightforward or lower value liquidations this will often be the most practical way of proceeding. It should be borne in mind that this option is entirely voluntary but, since it is commonly chosen, liquidators should be alive to the risks it carries in terms of litigation costs.

There is a distinction between "pure funders" and "commercial funders" which the court considers when awarding costs in litigation. A pure funder is someone who simply wishes to fund the litigation for its own sake. Pure funders (for example, a legal practitioner who undertakes work on a "no win no fee" basis) will not ordinarily be subject to adverse costs orders should the litigation fail. A commercial funder is someone who stands to make a commercial profit from the litigation. Where a commercial funder is funding the litigation and that commercial funder stands to benefit from the litigation, the commercial funder, even though a non-party, may be liable for the successful party's costs where the litigation fails. The potential benefit to a commercial funder is met by this concomitant risk. This is, of course, subject to the overarching rules that costs are discretionary and that non-party costs orders are the exception.

In *Burnden Holdings (UK) Ltd v Fielding* [2019] Costs LR 2061 the liquidator's firm funded part of the litigation itself. Had the litigation succeeded, the firm stood to recover 2.25 times the funding that it had provided. This arrangement made the firm a commercial funder and not a pure funder, so the court determined that it was therefore liable for a portion of the adverse costs occasioned by the failure of the litigation.

Where a company is impecunious and the liquidator's firm is being remunerated on the basis of a percentage of the recoveries, the firm can be considered loosely to be funding the litigation through its own time. This is permissible as a matter of the Insolvency Act, [4] and English case law has considered that this form of funding will not of itself make the firm a commercial funder.

While no BVI judgment has dealt with this issue, it is not clear on what basis the BVI Court would demur from these principles. The Civil Procedure Rules, 2000 permit the court to award the costs of litigation against a person who is not a party to that litigation (Civil Procedure Rules, rule 64.10). Therefore, a funder may be at risk of an adverse costs award in the BVI and a liquidator's firm which is funding the action beyond providing its own time may be exposed to the same risk as the firm in *Burnden*.

Even where a liquidator's firm decides that it can or would like to fund an action, it would be prudent for liquidators to seek quotes from third party funders to ensure that the creditors are getting the best deal reasonably available to them.

Third party funding

Where a liquidator is considering funding from a third party, more is at play than the usual business common sense expected of the liquidator. The English Court of Appeal has described decisions based upon the merits of a cause of action made by a liquidator who is not legally qualified to be "most unsatisfactory". [5] A liquidator should, therefore, seek legal advice when deciding whether to engage a funder.

The terms of any funding agreement should provide for what happens if an action fails and liquidators should be careful to carry out all necessary due diligence on the funder's financial position. It is common in the UK for funders to insure themselves with "After The Event" insurance. This form of insurance is not prohibited in the BVI, but nor is it regulated.

Security for costs

In the BVI, the court has the ability to award security for costs against a party under part 24 of the Civil Procedure Rules. Rule 24.3 sets out the factors which the court can take into account when making such an order. One of those is that "some person other than the claimant has contributed or agreed to contribute to the claimant's costs in return for a share of any money or property which the claimant may recover [...]".

The failure of a claimant to provide a copy of the funding agreement to the defendant was considered to be a factor weighing in favour of the granting of security of costs against the claimant in *Hualon Corporation (M) SDH BHD (in receivership) v Marty Limited* (BVIHC(COM) 2014/0090; 20 January 2016). In his judgment, Farara J considered that this failure "raises the serious likelihood that the claimant is either unable or unwilling to pay or to meet any costs awarded to the defendants in these proceedings."

In *Hualon*, the company was in receivership and being funded by a third party with the agreement of the receiver and the company's creditors. The company was a Malaysian registered company. It had failed to meet previous costs orders, had no assets in the BVI, and it was balance sheet insolvent, so a security for costs order was perhaps likely in any event. However, the judgment is an indication from the court that evidence that a funder can meet adverse costs orders will be expected if a party is to avoid a security for costs order.

The amount and nature of the security shall be such as the court thinks fit (Civil Procedure Rules, rule 24.2(4)). In the UK, a practice has developed whereby the amount of security to be paid by a funder will be limited to the amount of the funder's contribution and the BVI appears to embrace this approach (see *Leremeieva v Estera Corporate Services (BVI) Ltd* (BVIHCM 2017/0118; 4 April 2019)).

Conclusion

Liquidators in the BVI must be aware that they have fiduciary obligations and must at all times act in the best interests of the creditors as a whole. Liquidators are expected to exercise independent commercial judgement when realising the assets of the company, but where that asset is a cause of action, legal advice should be taken. There is a wide range of options for funding open to liquidators and they ought to consider them all. None of the options is risk free, but a fully informed and properly advised liquidator who can account for any expenditure will be much less exposed to the risk of censure from the court.

The decisions surrounding funding often have to be made in difficult circumstances when the liquidator is already busily trying to obtain basic information about the company's assets and liabilities, perhaps seeking legal advice and/or recognition in multiple jurisdictions and otherwise trying to secure the company's assets. The decision making process around funding is not straightforward and requires careful consideration and proper advice. Funders, liquidators and legal practitioners alike all have a role in ensuring best practice in this increasingly topical area.

[1] Not all causes of action are assignable, but suing on an assigned debt is permissible.

[2] There are a number of limited and rare statutory exceptions.

[3] *William Brandt's Sons & Co v Dunlop Rubber Tyre Co Ltd* [1905] AC 454.

[4] Section 432.

[5] *Faryab v Smith* [2000] 12 WLUK 340 at [38]

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