Insolvency Litigation Funding – What Should an Insolvency Practitioner Do?

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Abstract

Insolvency litigation is unlike other types of litigation. Although proceeds of successful actions are received on behalf of creditors creating a private benefit, there is also a public benefit to ensuring culpable individuals are held to account for their conduct. A significant problem often faced by insolvency practitioners, who have the power to take action on behalf of creditors, is how to fund such actions.

Many insolvent estates are so impecunious that there is no funding available to support litigation. The Jackson reforms were applied to insolvency litigation in 2016. Prior to that, an insolvency practitioner would invariably employ a legal team on the basis of conditional fee agreements ("CFAs") where, if successful, the lawyers would receive their base costs plus an uplift which was commonly 100% of the base costs. Insolvency practitioners would ensure they had potential adverse costs covered (in the event the action was lost) by after-the-event insurance ("ATE") where the insurance premium was fully deferred and not payable if the case was lost. Prior to 2016, if insolvency litigation was successful, a losing defendant would be ordered to pay damages, base legal costs, the CFA percentage uplift on those costs and the ATE insurance premium. All that changed with the Jackson reforms. From 2016 onwards, uplifts and premiums are no longer separately recoverable but must now be paid out of any damages awarded. The result is that fewer cases are brought using CFAs and ATE than before, and less money finds its way to the creditors.

In 2015, insolvency office-holder actions were made assignable to third party funders. Up until then, third party funders accounted for only a very small part of the insolvency litigation market. This was largely due to the fact that they would require a profit from any funding they provided and financially, the pre-Jackson CFA/ATE model was usually far more attractive to insolvency practitioners. The Jackson reforms have levelled this playing field.

Insolvency practitioners are fiduciaries. They must act in what they believe to be the best interests of the creditors. Prior to the ability to assign office-holder actions and the Jackson reforms, in the vast majority of cases, insolvency practitioners did not have to think too carefully about how best to fund insolvency. The CFA/ATE model was dominant. That has changed in recent years. This article considers in detail the options available to insolvency practitioners and

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considers the factors they need to take into account in making a decision as how best to enforce legal rights on behalf of creditors. It considers recent case law and the possible pitfalls which await an unwary practitioner. It concludes with a suggested checklist which might be used each time insolvency litigation which requires some form of financial support is contemplated.

Keywords

Insolvency litigation, litigation funding, insolvency practitioners

I. INTRODUCTION

The Jackson Reforms[1] came into force in 2013 under the terms of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 ('LASPO'). LASPO made changes both to the law and procedure governing how civil litigation is conducted in the UK. It generally abolished the right for successful claimants to claim, from a losing defendant, any uplift on a conditional fee agreement ('CFA') and the premium payable for after-the-event ("ATE") insurance (a policy taken out to safeguard against the possibility of suffering an adverse costs order if the claim is unsuccessful).[2] Jackson LJ had observed, in general terms, that the way CFAs had operated (often with 100% uplifts and deferred ATE premiums) was the cause of disproportionate costs incurred by successful claimants.

In recognition of the unique public policy issues involved, insolvency litigation[3] was granted an exemption from the LASPO reforms, initially for two years but subsequently extended[4] for a further year. The insolvency "carve-out" came to an end in April 2016.[5]

The Jackson Reforms were introduced with little or no consideration of their impact upon insolvency litigation.[6] Although the Government committed itself to a Post Implementation Review of LASPO between April 2016 and April 2018, that Review again did not address the effect of the reforms specifically on insolvency litigation.[7]

[1] The Reforms are based upon Lord Justice Jackson's recommendations found in *Review of Civil Litigation Costs: Final Report* TSO (December 2009) (see also the *Review of Civil Litigation Costs: Preliminary Report Volumes One and* Two TSO (May 2009) and the Government's subsequent consultation *Proposals for Reform of Civil Litigation Funding and Costs in England and Wales – Implementation of Lord Justice Jackson's Recommendations* (Cm 7947, November 2010) and its response to the results of that *consultation Reforming Civil Litigation Funding and Costs in England and Wales – Implementation of Lord Justice Jackson's Recommendations - The Government Response* (Cm 8041, March 2011).

[2] These specific changes were made by amendments to the Access to Justice Act 1999.

[3] In this context insolvency litigation in general terms refers to litigation brought by liquidators or administrators of companies or trustees in bankruptcy. See Legal Aid, Sentencing and Punishment of Offenders Act 2012 (Commencement No 5 and Saving Provision) Order 2013 SI 2013/77 art 4 and the Ministerial Statement dated 24th May 2012 by the then Minister of Justice Jonathan Djanogly.

[4] See the written statement by Lord Faulks QC, the Minister of State for Civil Justice on 26th February 2015.

[5] The announcement was made on 17th December 2015 by Lord Faulks QC, the Minister of State for Civil Justice and may be found at: http://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2015-12-17/HCWS420/.

[6] Although a number of Parliamentary Written Questions were answered in terms which suggest the issue of insolvency litigation was considered in the Parliamentary LASPO Impact Assessment, there is no evidence that that was in fact the case (see for example, the answers to Written Questions 13344, 13345, 13342, 13343, 13333, 15406 provided by Dominic Raab MP, Parliamentary Under-Secretary (Ministry of Justice) in November 2015).

[7] See paragraph 1.2 of the Post-Implementation Review of Part 2 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (LASPO) Civil litigation funding and costs February 2019 found at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/777039/post-implementation-review-of-part-2-of-laspo.pdf.

Independent research was published by the author in both 2014[8] and 2016[9]. For an in-depth consideration of the history of, and public policy considerations involved in, support for insolvency litigation, the reader is directed to the two previous reports.[10] The aim of both the 2014 and 2016 reports was to assist Government policy making by providing evidence as to how insolvency litigation was funded at that time and the likely effect that the Jackson Reforms would have on the market. The two reports recognised a developing third party funding market but considered that the introduction of the Jackson Reforms to insolvency litigation would lead to a significant reduction in the funds brought into insolvent estates and distributed to creditors.

In the Summer of 2019 I was commissioned by Manolete Partners plc,[11] the UK's leading insolvency litigation funder, with the support of the ICAEW[12] and the IPA,[13] to conduct research in order to assess the current state of play in the insolvency litigation funding market. The subsequent report, *Insolvency Litigation Funding - in the best interests of creditors?*[14] ("the Report") published in April 2020 attempts to assess where we are now, in relation to what is happening in practice, and considers what insolvency practitioners ("IPs") should be doing when assessing what to do with a potential legal cause of action.

The Report has a number of sections. It begins with an outline of the recent history of the legal framework governing how insolvency litigation has operated up to the present day. It then assesses the legal issues affecting how IPs carry out their duty to act in the best interests of creditors. This is followed by an examination and analysis of various qualitative and quantitative data.

This article is based upon the section in the Report which considers the legal issues affecting how insolvency practitioners address their duty to act in the best interests of creditors in the context of how they choose to fund insolvency litigation. It looks at the consequences in this context of the IP acting as a fiduciary. The various methods or tools available to an IP to finance or otherwise support insolvency litigation are considered along with possible legal or practical pitfalls which accompany them. The article concludes with a summary of the legal and practical issues an IP needs to consider whenever he or she is considering conducting litigation.

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[8] *The Likely Effect of the Jackson Reforms on Insolvency Litigation – an Empirical Investigation* commissioned by R3 (with the support of ACCA, ICAEW, ICAS, IPA, JLT Specialty Ltd, Moon Beever and Moore Stephens LLP) which may be found on the R3 website.

[9] *Insolvency Litigation and the Jackson Reforms – An Update* R3 (with the support of ACCA, ICAEW, ICAS, ILA, IPA, JLT Specialty Ltd, IRS and Willis Towers Watson) which may be found on the R3 website.

[10] See Sections 3 and 4 of the 2014 Report and Section 3 of the 2016 Update.

[11] I am most grateful to Manolete Partners plc, and in particular its CEO, Steven Cooklin and non-executive director, former Chief Bankruptcy Registrar Baister. Although ensuring the report was produced entirely independently they have assisted me with their experienced insights and most generously with access to confidential information about Manolete Partners plc's case load. I am also grateful to Manolete Partners plc for their consent to the use of part of the Report in this article. In addition, it is important to note that the project would not have been possible without the active support of the ICAEW and IPA. My thanks go in particular to the ICAEW's Bob Pinder and the IPA's Michelle Thorp.

[12] Institute of Chartered Accountants in England and Wales.

[13] Insolvency Practitioners Association.

[14] Available online on the respective websites of the ICAEW and IPA and at: https://wlv.openrepository.com/bitstream/handle/2436/623175/Insolvency%20Litigation%20Funding%20In%20the%20best%20interests%20of%20creditors%20April%202020.pdf?sequence=3&isAllowed=y.

II. INSOLVENCY PRACTITIONER ("IP") DUTIES WHEN REALISING A CAUSE OF ACTION

(a) The IP as a Fiduciary

An IP is a fiduciary,[15] a person who has undertaken to act for, or in the interests of, another and whose activities can be supervised in equity so as to prevent their being used for personal advantage.[16] In *Bristol & West Building Society v Mothew*[17] Millett LJ stated that:

> "The distinguishing feature of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and interest may conflict; he may not act for his own benefit or for the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations".

In an insolvency context, the fiduciary duties owed by an IP include the duty to act bona fide within the IP's powers and a duty to act in the best interests of the company's creditors as a whole.[18]

(b) IPs and Remuneration

An IP will normally seek to be remunerated and, as a fiduciary, can only claim remuneration which has been authorised.[19] The IP will have to justify the claim. This is one aspect of a fiduciary's obligation to account. Money retained by the IP out of the estate's property is not available to the creditors. The IP must account for it by showing that he or she ought to be allowed to retain it. He or she must explain the nature of the tasks which have been undertaken and the reasons why they were carried out in that way as well as the amount of time and effort spent upon them. If an IP agrees with the insolvent estate's creditors that he or she should be remunerated according to a percentage of realisations, and so in one sense, is funding the action through his or her own time, this does not constitute the IP a "commercial funder".[20]

(c) Duty of Care to Creditors

In addition to acting *bona fide* and within their powers, the actions of, and decisions made by, IPs will be judged according to the standard of the reasonable person acting in his or her own affairs. They are expected to display reasonable commercial judgement[21] and not act regardless of expense. Transactions which incur high costs will be subject to close scrutiny.

An IP owes a duty to act with reasonable care and skill. In this regard the standard by which he or she is judged is the standard of a reasonably skilled and careful practitioner.[22] If an IP decides to sell a company's business or a particular asset, the IP owes a duty of care in

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[15] This was the starting point from which Ferris J developed his judgment in *Mirror Group Newspapers plc v Maxwell (No 2)* [1998] 1 BCLC 638.
[16] H Anderson, *The Framework of Corporate Insolvency Law* (Oxford, 2017) paras 11.08-11.12.
[17] [1998] Ch 1 at 18.
[18] *BTI 2014 LLC v Sequana SA* [2019] EWCA Civ 112 for which see P Walton "Directors' duty to act in the interests of creditors under section 172 of the Companies Act 2006 – Aussie Rules Gone Walkabout BTI 2014 LLC v Sequana SA" (2019) 2 *Wolverhampton Law Journal* 47.
[19] See Rules 18.15 to 18.38 of the Insolvency (England and Wales) Rules 2016 (SI 2016/1024).
[20] *Burnden Holdings (UK) Ltd v Fielding* [2019] EWHC 2995 (Ch) at [44].
[21] *Re T & D Industries plc* [2000] 1 WLR 646.
[22] *Re Charnley Davies Ltd (No.2)* [1990] BCC 605.

relation to the choice of the time to sell and the taking of appropriate available valuation and marketing steps calculated to achieve the best price.[23]

Allegations of breach of fiduciary duty and the duty of skill and care were upheld by the court in *Brewer v Iqbal*.[24] The IP had breached his fiduciary duty by failing to act single-mindedly for the company. He had failed to take account of matters which he should have taken into account whilst taking into account matters he should not have taken into account. He had failed in this duty to exercise reasonable skill and care with regard to marketing and valuing of the company's assets.

IPs may be in breach of duty if they fail to give proper consideration as to how they ought to exercise their discretionary powers. The court in *Brewer* recognised that, in certain circumstances, a failure to take professional advice will amount to a flawed decision-making process.[25]

(d) Duties of IPs when realising a Legal Cause of Action

When an IP becomes aware of a possible cause of action capable of being pursued in order to benefit a company's creditors, he or she has a wide discretion as to what to do. The IP will need to be familiar with the circumstances of the case. It will be important to consider whether the proposed defendant has sufficient wealth to satisfy any possible successful judgment. The IP will need to consider the likelihood of success of the action. The insolvent estate may have sufficient funds within it to finance an action (including the contingent cost of an indemnity for any personal liability incurred by the IP if the case is lost). In such cases, IPs may legitimately use those funds to take action, provided that they exercise proper commercial judgement, consider whether they would hazard their own money in the way planned and keep the costs under review to ensure that they are justified. On the other hand, and very much more commonly in an insolvent estate, it may be impecunious. Whether or not there is funding available in the insolvent estate, it will be important to consider the options available.[26] They will usually include the following (or a combination of them):

- i) do nothing;
- ii) ask creditors to fund the action;
- iii) fund the action themselves or get their IP firm to do so;
- iv) enter into a CFA with their legal team with or without ATE insurance;
- v) enter into a funding agreement or assignment of the proposed cause of action with a third party funder; or
- vi) enter into a damages based agreement.[27]

If an IP is uncertain which course to follow, in many situations he or she may attempt to seek directions from the court but it would seem unlikely that the courts will help in this context.

[23] See e.g. *Davey v Money* [2018] EWHC 766 (Ch); [2018] Bus. L.R. 1903; *Silven Properties Ltd v Royal Bank of Scotland Plc* [2000] BCC 727.
[24] [2019] EWHC 182 (Ch); [2019] BCC 746.
[25] See *Pitt v Holt* [2013] UKSC 26; [2013] 2 AC 108 which was followed in *Brewer*.
[26] The cost of issuing proceedings itself may be an issue especially where the estate is impecunious (see SI 2008/1053 Civil Proceedings Fees Order 2008 (SI 2008/1053), Schedule 1 of which states the fee for commencing an action in the High Court or County Court where, for example, if the claim is for over £200,000, the fee is £10,000). It is not uncommon for IPs themselves to fund such fees out of their own money.
[27] There is no evidence that any IP has yet entered into a damages based agreement. There is perceived to be an insuperable conflict of interest facing lawyers who agree to such agreements. If a lawyer wishes to be benefit from a percentage of any proceeds of an action, there is the concern that the IP would not be acting in the best interests of the creditors by agreeing to such an agreement rather than a more conventional conditional fee agreement. Whatever the reasons for the widespread reluctance to adopt damages based agreements, they are not used in insolvency practice and so will not be considered further in this report.

When there is a decision to be made by an IP which is essentially a commercial decision the IP will not be allowed to use the court "as a sort of bomb shelter"[28]. An IP, when acting as liquidator or trustee in bankruptcy no longer requires the consent of creditors (or the Insolvency Service) prior to taking legal action.[29] The IP might be wise to take account of the views of the creditors prior to taking legal action or assigning a cause of action but ultimately he or she is responsible for how the discretionary power is exercised.

Any course of action should be intended to lead to an advantage to the creditors. Whatever the IP decides to do it is plainly correct that the IP should take more account of the views of the creditors than the directors of the company.[30] If the only advantage to the creditors is the indirect benefit that the IP's fees will be covered, that would appear to fall short of what is required of the IP.[31]

(i) Do Nothing

Although a number of IPs are risk averse, they must be aware that if they decide not to pursue the realisation of a cause of action, they may be failing in their duties to creditors unless they have made a documented, reasoned and reasonable decision not to pursue the claim. It is not open to an IP not to investigate potential causes of action. Where an IP has been appointed, effectively by those in control of a company, the IP must not accept the opinions and views of directors but must exercise independent judgement in deciding what to do with a company's assets.[32]

An IP has a statutory duty to report on potential unfit conduct by directors under the Company Directors Disqualification Act 1986.[33] If there is evidence of such misconduct, the IP must consider, and take appropriate advice, as to whether a cause of action is available against the directors, which may lead to some benefit to the company's creditors. If an IP is aware that disqualification proceedings are to be taken against a director by the Secretary of State, the IP may wish to liaise with the Secretary of State's team as to any likelihood that a compensation order under section 15A of the Company Directors Disqualification may be pursued. This may prove to be an efficient way to effect a return to the company's creditors with little or no cost to the insolvent estate.

If there is a possible cause of action but the IP is considering doing nothing about it, it would make sense for the IP to offer a full assignment of the action for a single one-off payment to a funder. Even if the funder passes on the offer, the IP will be able to demonstrate that a genuine attempt to realise its value has been made.

(ii) Ask Creditors for Funding

Although once commonplace, it has become reasonably rare in the past twenty years or so, for a creditor to fund insolvency litigation. It remains a possibility and an IP will usually approach the insolvent estate's creditors to see if they are prepared to fund any proposed action. Most creditors are reluctant to risk further sums when they already stand to lose money in the insolvency. In a previous research report,[34] it was suggested that the UK might

[28] *Re T & D Industries plc* [2000] 1 WLR 646 at 657 per Neuberger J.
[29] See sections 120 and 121 of the Small Business, Enterprise and Employment Act 2015. Although a liquidator has always had the power to dispose of company property, which would include assignment of a company action, this power did not include office-holder actions until section 118 of the 2015 Act permitted assignment of such actions.
[30] *Faryab v Smith* [2001] BPIR 246 per Robert Walker LJ at [42].
[31] *Faryab v Smith* per Judge LJ at [49].
[32] *Brewer v Iqbal* [2019] EWHC 182 (Ch); [2019] BCC 746.
[33] Company Directors Disqualification Act 1986, section 7A.
[34] See Section 5 of the 2016 Update.

consider adopting a version of the Australian system where creditors are rewarded with an increased return if they decide to fund insolvency litigation. It is difficult to understand the reluctance of the UK Government to consider the introduction of such a procedure.

Prior to the abolition of the Crown's preferential status by the Enterprise Act 2002, Crown creditors, such as the predecessors to HMRC were often willing to fund insolvency litigation. In recent years, HMRC has only supported financially a relatively small number of such cases (usually limited to cases involving allegations of fraud). It might be that with the imminent reintroduction of HMRC as a preferential creditor[35] this may change. As the proceeds of most litigation will form part of the insolvent estate, HMRC, as a preferential creditor, is likely to be the primary recipient of any dividend. It would therefore make a great deal of sense for HMRC to return to its pre-Enterprise Act practice of routinely funding insolvency litigation. There is also the possibility of negotiating a "matched funding" agreement along with a commercial funder.

It is possible that secured creditors may occasionally fund certain actions by IPs. The reintroduction of the Crown preference will most likely act as a deterrent to other unsecured creditors. Absent the adoption of a form of the Australian system of rewarding creditors who provide funding support, the lion's share of any proceeds of any successful action are likely to go (after costs) to HMRC.

(iii) IP Firm Funds the Action

There appears to be a small number of IP firms who engage in funding insolvency actions being brought by their own IPs (that is IPs who are partners in or employed by those firms)[36]. There are some potential concerns and dangers in doing so, some of which are highlighted by the case of *Burnden Holdings (UK) Ltd v Fielding.*[37] The court has a jurisdiction to award costs against a third party under s. 51 of the Senior Courts Act 1981.[38] The court looks to do what is just in the circumstances. It will generally not impose liability for costs on what are termed "pure funders", which means those who have no interest in the litigation, who are not funding it as a matter of business and do not look to control the action. If the non-party to the action looks to exercise control over it or is to benefit from a successful conclusion, justice will usually require, in the event the action fails, that the non-party pays the successful side's costs. It will be acting as a "commercial funder". [39]

The principle applicable is that if an IP firm funds an action and looks to benefit from that funding, it will usually be ordered to pay adverse costs if the action is lost. In *Burnden*, the IP firm funded part of an action and, had it been successful, would have recouped approximately 2.25 times the funding provided. The court found it to be acting as a "commercial funder" and was therefore liable for a part of the adverse costs of the successful party.

There is also a potential issue around conflict of interest and duty if an IP's own firm acts as a funder for one of the IP's actions. It would seem that an IP in such circumstances should consider obtaining offers from third party funders to ensure that the insolvent estate and its creditors are getting the best deal available in the market.

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[35] HMRC is due to regain its preferential status, at least for some taxation debts, from 1st December 2020 (see *HM Treasury Budget 2020 Statement* HC 121 March 2020 at paragraph 2.261 - Protecting your taxes in insolvency.

[36] The suggestion that an IP might make a payment as security for costs in an action was described by Marcus Smith J in *Absolute Living Developments Limited (In Liquidation) v DS7 Limited* [2018] EWHC 1432 (Ch) at [33] as "entirely unusual" and the prospect of such payments being made as "theoretical or fanciful".

[37] [2019] EWHC 2995 (Ch).

[38] For the general principles the court uses when considering exercising this jurisdiction see: *Dymocks Franchise Systems (NSW) Pty Ltd v Todd* [2004] 1 WLR 2807 (PC) at [25].

[39] [2019] EWHC 2995 (Ch) at [6].

If the basis for remuneration of an IP, in an impecunious insolvent estate, is a percentage of realisations, he or she is not, without more, constituted as a "commercial funder".

Similarly, if an IP firm (or solicitors' firm) supports an action by relatively "low-level"[40] funding, which is limited in nature and common within the profession, such funding support will not constitute the IP firm as a "commercial funder". They will be seen as a "pure funder" and acting merely to facilitate access to justice for the insolvent estate.[41]

(iv) CFA (with or without ATE)

Since the Jackson Reforms were applied to insolvency litigation, any CFA uplift (commonly, but not invariably set at the maximum permissible100% of the lawyers' base costs[42]) and ATE premium are no longer separately recoverable from a losing defendant.[43] Such costs must be paid out of any damages awarded or settlement reached.

The obvious risk from an IP's viewpoint in such cases is that the recovery may not be sufficient to cover the legal team's fees (and disbursements) and any ATE premium. The more complex or drawn-out a matter becomes the more likely these fees are to increase. Even in reasonably large claims the IP may find that there is little left for creditors once the legal team's fees, the ATE premium and the IP's own fees are paid. The IP must, based up the best advice available, make a professional judgement as to whether this mode of funding the action is likely to be in the best interests of the creditors.

The IP needs to consider carefully the terms of any CFA (and ATE policy). In Stevensdrake Ltd (t/a Stevensdrake Solicitors) v Hunt[44] a claim was successfully settled for a sum of £1.9m which would have been more than sufficient to cover legal costs (and the CFA uplift). The money was never recovered as the defendant became bankrupt. The terms of the CFA expressly provided for the IP to be personally liable for the legal costs (and uplift) if the action were a success. Under the terms of the CFA, the action had been a success even though no recovery had been made. The liability to pay was not limited by reference to funds available in the liquidation. The CFA imposed personal liability to pay the legal fees on the IP regardless of actual recoveries.

The case highlights a real risk for IPs. It suggests an IP needs to read carefully and fully understand the terms of a CFA (and indeed an ATE policy). It would appear wise for IPs in such cases to take independent legal advice on their potential personal liability. It would not always be sensible to rely upon any advice as to the effect of any CFA contract which is provided by the legal team with whom the CFA is being entered. That legal team is not in a position to provide independent advice on the terms of the CFA. If the IP has not fully understood the implications of the CFA's terms, it seems it would be arguable that the legal team has breached its duty to the IP by not fully explaining its terms and its practical implications.[45]

ATE insurance is commonly purchased by IPs (and funders) when taking legal action of any significance. It has been stated judicially that unless there is evidence to the contrary, a properly drafted ATE policy provided by a substantial and reputable insurer will be seen by the

[40] [2019] EWHC 2995 (Ch) at [47].
[41] [2019] EWHC 2995 (Ch) at [41].
[42] See paragraph 3 of the Conditional Fee Agreements Order 2013 (SI 2013/689) which limits the percentage uplift legally possible under section 58 of the Courts and Legal Services Act 1990 to 100%.
[43] See paragraph 2 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (Commencement No 12) Order 2016 (SI 2016/345) which came into force 6th April 2016 and brought litigation by administrators, liquidators and trustees in bankruptcy within the limitations of sections 44 and 46 of LASPO 2012.
[44] [2017] EWCA Civ 1173; [2017] BCC 611.
[45] *LF2 Ltd v Supperstone* [2018] EWHC 1776 (Ch); [2019] 1 BCLC 38 at [46].

courts as a reliable source to satisfy any application for security of costs.[46] Despite this general approach, the court has recently commented, in *Rowe v Ingenious Media Holdings plc*[47] that an ATE policy with a number of exclusions contained within it may not be seen as adequate security for costs. As Nugee J commented:

> "The fundamental difficulty is that an ATE policy, as recognised on both sides, is not designed as security for costs. It is designed as cover for the Claimants, and like all insurance, insurers are astute to protect themselves from behaviour of the insured which changes the risk they have agreed to undertake… I suspect the problems that have been identified could be solved, and there may be something to be said for litigation funders and ATE insurers to seek to develop a form of policy that could both act as insurance for claimants and sufficient protection for defendants."[48]

A funder with the benefit of such an ATE policy may still need to provide sufficient assets to cover an order for security of costs. It would appear sensible for an IP to consider closely the terms of any ATE policy and negotiate terms which will do what the IP needs it to do.[49]

The decision to instruct solicitors and counsel is simply a decision to sub-contract work which IPs are entitled and (at least in theory) able to do themselves. In Jacob v UIC Insurance Co Ltd[50] the court explained that whenever IPs chose to retain their own firms for work in an insolvency procedure they ought to negotiate the best rates possible. IPs must look to achieve the best value for the creditors. This principle must also apply to any decision as to how to take legal proceedings. It would cover any decision to instruct a legal team. It would similarly cover any decision to engage with third party funders. The IP must decide which route would bring best value to the estate.

The IP must decide which funding model (or combination thereof) to adopt as well as negotiate appropriate terms. This may involve considering the percentage uplift on any CFA and any percentage of realisations to be retained by a funder. In reaching that decision, the IP must consider whether there is the need to test the market. The IP must be able to support with reasons the decision made if it is later questioned. The IP must decide what to do with the IP's fiduciary obligations firmly in mind.

(v) Engaging with a Funder or Assignee

Decisions facing an IP are generally left to the commercial judgement of the IP.[51] In the context of assigning a cause of action the Court of Appeal, in *Faryab v Smith*[52] has observed that:

> "the realisation of a cause of action (especially a cause of action of some complexity) is … less obviously a matter for business common sense than the realisation of more

[46] Under CPR 25.12 and 25.13. See *Geophysical Service Centre Co v Dowell Schlumberger (ME) Inc* [2013] EWCH 147 (TCC) at [15] and *Premier Motorauctions Ltd v PricewaterhouseCoopers* [2017] EWCA Civ 1872; 2018 1 WLR 2955 at [31]. A court will be alive to the possibility of an anti-avoidance clause which permits the insurer to avoid the insurance contract on the basis of non-disclosure or misrepresentation.
[47] [2020] EWHC 235 (Ch). To similar effect see the comments made by the court in *Re Hotel Portfolio II UK Ltd* [2020] EWHC 233 (Comm).
[48] [2020] EWHC 235 (Ch) at [136 -138].
[49] See the commentary in A Jay "Recent developments in litigation funding" (2019) 6 *Corporate Rescue and Insolvency* 218.
[50] [2006] EWHC 2717.
[51] See the discussion in *LF2 Ltd v Supperstone* [2018] EWHC 1776 (Ch); [2019] 1 BCLC 38 at [55] as to whether an IP ought not to assign a claim where the action by the assignee might be one which the IP believed to be frivolous or vexatious.
[52] [2001] BPIR 246.

> conventional assets such as freehold or leasehold property, stock in trade or other tangible moveable property."[53]

In the same case, the Court of Appeal described decisions, based upon the strength or otherwise of a legal cause of action, made by an IP who was not a lawyer as "most unsatisfactory"[54].

The Court of Appeal also commented on the facts, that it was not "wholly immaterial" that the amount received for the assignment of the action coincided with the IP's estimate as to his likely fees and expenses. Although not making any imputation against the IP, the Court of Appeal did recognise that "his natural concern about his own position must have played some part in the decision-making process"[55]. The court does have jurisdiction to intervene in cases where IPs have reached decisions in good faith but where they had "not followed a satisfactory decision-making process and had not reached a satisfactory decision."[56] In deciding whether, and on what terms, to assign a cause of action (or engage a funder), an IP must take professional legal advice. Once the IP has received advice on the strengths and weaknesses of the claim, the IP must still exercise his or her independent judgement as whether to take any action and if the decision is to take action, the IP must then decide how best to realise the claim.

One obvious comparator when considering an assignment of an action to a commercial funder would be to investigate how much, if anything, the prospective defendant would be willing to pay for the cause of action.[57]

Whenever an IP is aware of the potential value of a cause of action, he or she must act to obtain a proper payment for any assignment of the action. If the value of the action is not clear, the IP ought to consider some process of inviting rival bids or to hold an auction of the cause of action. Money received will benefit either the creditors directly, if there is an eventual dividend paid, or indirectly, by enabling (at least part of) the expenses of the IP to be met.[58]

The position would appear to be similar where engagement with a funder does not lead to an assignment of the cause of action but instead allows for funding to be provided to the IP to enable the IP to pursue the action.[59]

One clearly significant difference between on the one hand funding being provided and on the other, an outright assignment of the action, is that in the latter, the IP loses control of the action. Depending upon the terms agreed with a funder, the action may be settled quickly by an assignee funder, in circumstances where an IP may have wished to continue the action with the aim of a greater return in the longer term. The loss of control, speed of resolution and probability of success, are all matters, along with the actual financial figures agreed, an IP will need to take into account prior to agreeing terms with a funder.

Another potentially significant problem for a funder is the possibility that if its services fall within the terms of the Damages Based Agreements Regulations 2013, the court may find

[53] *Faryab v Smith* per Robert Walker LJ at [32].
[54] *Faryab v Smith* per Robert Walker LJ at [38].
[55] *Faryab v Smith* per Robert Walker LJ at [39].
[56] *Faryab v Smith* per Robert Walker KJ at [45]
[57] *Faryab v Smith* is an example of such an assignment being made albeit in the absence of appropriate legal advice. An IP needs also to satisfy the provisions of Statement of Insolvency Practice 13 if a cause of action is assigned to a person connected with the company or debtor. In such cases, the IP needs to demonstrate that he or she has acted with due regard to creditors' interests by providing creditors with a proportionate and sufficiently detailed justification of why a sale to a connected party was undertaken, including the alternatives considered.
[58] *LF2 Ltd v Supperstone* [2018] EWHC 1776 (Ch); [2019] 1 BCLC 38 at [67].
[59] IPs should be careful to avoid engaging the support of a funder which might breach the terms of the Damages Based Agreements Regulations 2013 (SI 2013/609) for which see *Meadowside Building, Developments Ltd (In Liquidation) v 12-18 Hill Street Management Company Ltd* [2019] EWHC 2651 (TCC).

that the agreement with the IP does not comply with those Regulations and decide, on that basis that the whole agreement is also champtertous at common law.[60]

Funders' liability

It is clearly important that the terms upon which a funding agreement is agreed considers what happens both where the action is successful and where it fails. If it fails, a "commercial funder" will need to understand the extent of its liability for adverse costs. It may self-insure these costs or purchase appropriate ATE insurance. The court may ask for evidence that a commercial funder has sufficient assets to cover any adverse costs. If such evidence is not forthcoming, the court is likely to order security for costs against the IP or the funder.[61] If the funding agreement is found to be champertous, which will be the case if, for example, the terms of a CFA breach permit an uplift of greater than 100%, the funder's liability for adverse costs will be unlimited.[62]

In general terms, the court wishes to ensure that funders are not dissuaded from funding actions but also that successful defendants have the ability to recover at least part of their costs where an impecunious claimant's action has failed. There are two factors or approaches to assessing a funder's liability for adverse costs that the court will take into account in ensuring its decision achieves a just result.

The court may limit a commercial funder's liability for adverse costs: 1) to the amount of the funder's contribution – the so-called Arkin[63] Cap; and 2) to the costs incurred by the winning party during the period when the funder had acted as such.[64] Funders should be aware that the Arkin Cap is not a rule but an approach which the court ought to consider in reaching a just result. The approach was determinative in the Burnden case but for a number of reasons was not followed in Davey v Money[65] (upheld on appeal[66]).The fact that each case will turn on its individual circumstances creates an uncertainty for funders in attempting to predict the likely sum of any security for costs which may be ordered.

Security for Costs

As is well understood, insolvency litigation has a number of characteristics which may distinguish it from other civil litigation. If an IP decides to take legal action, the defendant will often ask the court to order security for the defendant's costs against the insolvent estate represented by the IP. It is, of course, possible that an insolvent company will have sufficient assets available to cover that security[67] but in many cases the company will be impecunious

[60] *Meadowside Building, Developments Ltd (In Liquidation) v 12-18 Hill Street Management Company Ltd* [2019] EWHC 2651 (TCC) at [114].

[61] *Re RBS Rights Issue Litigation* [2017] EWHC 1217 (Ch); [2017] 1 WLR 4635 and *Re Hotel Portfolio II UK Ltd* [2020] EWHC 233 (Comm).

[62] *Arkin v Borchard Lines Ltd (Nos 2 & 3)* [2005] 1 WLR 3055 at [40].

[63] Named after the case *Arkin v Borchard Lines Ltd (Nos 2 & 3)* [2005] 1 WLR 3055.

[64] *Burnden Holdings (UK) Ltd v Fielding* [2019] EWHC 2995 (Ch) at [8] – [11].

[65] *Davey v Money* [2019] EWHC 997 (Ch); [2019] 1 W.L.R. 6108 at [48] – [111] and summarised in *Burden* at [16] in the following terms: "i) The funder had approached its involvement throughout as a commercial investment. ii) The litigation was sufficiently out of the norm to warrant the making of an indemnity costs award against the claimant. While the funder had not itself directed the way the case was conducted, it had sufficient opportunity to investigate and form a view as to the nature of the claim and the support for the allegations being made before choosing to fund it. iii) The funder must have known that the claimant was most unlikely to be able to pay any substantial costs awarded against her. iv) The funder had halved its commitment to funding but retained the same potential share of recoveries, which highlighted the commercial self-interest motivating it. v) The funder had negotiated to receive a substantial commercial profit which would have taken priority over any compensation payable to the claimant.

[66] *Chapelgate Credit Opportunity Master Fund Limited v Money* [2020] EWCA Civ 246.

[67] Adverse costs will normally be paid as an expense in the administration or liquidation – see rules 3.51 and 7.108 of the Insolvency (England and Wales) Rules 2016 (SI 2016/1024).

or at least unable to meet an order for adverse costs. Under CPR 25.12 and 25.13, the court may order security for costs if there is reason to believe the company will be unable to pay the defendant's costs if ordered to do so.[68]

In such cases, the IP may argue that any order for security of costs will unfairly stifle the claim. In order to convince the court that the action would be stifled, the IP must put evidence before the court as to the company's means and must satisfy the court, to a standard of probability, that an order for security of costs would stifle the action. The court will assess the claimant's ability to provide security by looking at the company's assets but will also likely consider whether such security might be expected from third parties such as creditors, shareholders, associated companies, ATE insurers or third party funders. The burden is on the IP to provide evidence as to whether such security is likely or unlikely to be available from such sources.[69] Although the support of an ATE insurer or funder is often deemed essential by an IP in such cases, it should be borne in mind that the court will not order security for costs if there are good reasons why there is no-one in the background who can provide such security.[70] Equally, unless the court is convinced that ATE insurance or the capital value of the funder in question is a reliable source to cover any adverse costs, an order for security for costs will still be made.[71]

There is therefore much to be said for an IP conducting due diligence into how its proposed funder operates. If there is a lack of transparency about the funder's capital value it will not be capable of "self-insuring" and will usually need to take out ATE insurance to cover possible adverse costs. The ATE premium will add a cost to the action, and unless its terms have been negotiated carefully, may not survive an application for security for costs.

(vi) Damages Based Agreement ("DBA")

A DBA allows for a fully contingent fee in that lawyers (or others providing services to IPs) may agree to receive a percentage of any damages awarded (subject to a cap of 50% of damages paid)[72]. There are concerns from lawyers that the very prescriptive requirements for DBAs, with the consequence of non-compliance being that they are unenforceable, have put many off using DBAs. There is also perceived by some lawyers to be an insuperable conflict of interest facing lawyers who agree to such agreements. If a lawyer wishes to benefit from a percentage of any proceeds of an action, there is the concern that the IP would not be acting in the best interests of the creditors by agreeing to such an agreement rather than a more conventional CFA.

There is some interest in the possibility of a future hybrid form of DBA, whereby in any event, lawyers would be able to recover a maximum of 30% of their costs. This may prove attractive to IPs and their lawyers in future if such a partial or hybrid DBA becomes legally possible. A recent independent review[73] of DBAs may still breathe life into the DBA concept.

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[68] An order for security for costs is to be seen as a weapon to be used by a defendant to obtain swift summary judgment. It is intended to provide the claimant with options, that is, a choice as to whether to provide the security ordered or to discontinue the claim (*Prince Radu of Hohenzollern v Houston* [2006] EWCA Civ 1575 at [18]).

[69] *Burnden Holdings UK Ltd v Fielding* [2017] EWHC 2118 (Ch) at [87- 92] citing amongst other authorities, *Brimko Holdings v Eastman Kodak Company* [2004] EWHC 1343 (Ch) at [11].

[70] For an example where the court refused to order security of costs in the sum of £500,000 against a company in liquidation, as such an order would stifle the claim, see *Absolute Living Developments Limited (In Liquidation) v DS7 Limited* [2018] EWHC 1432 (Ch).

[71] *Re Hotel Portfolio II UK Ltd* [2020] EWHC 233 (Comm).

[72] See in general section 58AA of the Courts and Legal Services Act 1990 and the Damages Based Agreements Regulations 2013 (SI 2013/609).

[73] *The DBA Reform Project 2019* was carried out at the request of the Ministry of Justice by Nicholas Bacon QC and Professor Rachael Mulheron of Queen Mary University London. The project report and related documentation may be found at: https://www.qmul.ac.uk/law/research/impact/dbarp/.

Whatever the reasons for the widespread reluctance to adopt DBAs, there is little evidence that they are used in insolvency practice. In the small number of cases where they have been used successfully, there remains anecdotal evidence that they may not have been fully compliant with legislative provisions, and so, may have been found to be unenforceable if the point had been pursued. It may be that DBAs become more popular in the future but legislative change would appear to be necessary for them to be taken up in significant numbers in the insolvency context.

III. CONCLUSION - WHAT SHOULD AN IP DO?

It is clear that the decision facing an IP as to how to realise the value of a cause of action is often "nuanced and difficult"[74]. It would seem from the above discussion that IPs need to have in mind the following fundamental propositions when contemplating litigation:

(a) The fiduciary nature of their duties.

(b) They must therefore act in what they believe to be the best interests of the creditors.

(c) They must keep proper records of their decision-making processes so as to be able to account for expenditure made.[75]

(d) They must ensure that both their time costs and any costs such as legal costs are best value for money.

(e) They are expected to exercise proper commercial judgment when realising any asset but when realising a cause of action they will need to take legal advice.

(f) The whole range of funding options must be considered and a judgement must be made as to which is in the best interests of the creditors, not merely which is most likely to ensure the payment of the IPs' fees.

(g) It may be necessary to approach a number of funders or assignees in order to ensure the IP can be seen to be taking reasonable care to act in the best interests of creditors.

(h) IPs must recognise the risks inherent in different funding options.

IPs are in a difficult position. They need to make important commercial decisions, often without the luxury of much time to consider their decisions. They cannot simply "play safe" and avoid taking action if their investigations uncover culpable and actionable behaviour. IPs need to take account of what will be in the best interests of creditors. This will usually result in IPs making a decision calculated to realise the best financial result for creditors. Only if IPs are fully familiar with different funding options will IPs be able to make a reasoned and informed decision. It is incumbent on IPs to ensure that decisions on how best to enforce causes of action are fully informed. There is a clear part to play here for the insolvency professional and trade bodies. IPs need to be educated and provided with guidance so that their decisions are, and are seen to be, in the best interests of creditors.

[74] *Absolute Living Developments Limited (In Liquidation) v DS7 Limited* [2018] EWHC 1432 (Ch) at [33].
[75] The provisions of Statement of Insolvency Practice 2 must be satisfied in this regard.