Litigation: A valuable asset class for insolvency practitioners

Gwilym Jones and Piers Elliott ask if a bird in the hand is worth two in the bush?... and how to stretch an analogy to its limit

GWILYM JONES
Managing Director, Henderson & Jones, London

PIERS ELLIOTT
Director – Legal, Henderson & Jones, London

> *The biggest deterrent to pursuing litigation is often the cost*

There is value in certainty, and it is hard to get certainty in litigation – which is an inherently risky endeavour.

Historically, litigation assets within insolvent estates have been difficult to realise and have often been overlooked as a result. In the past, valuable claims would be abandoned because of a lack of funds to pursue. Alternatively, they would be compromised at an early stage, on unfavourable terms, to protect against an aggressive defendant attempting to take advantage of the uncertainty caused by the insolvency. Often, key information required to evidence the case is missing or difficult to identify from within the insolvent entity's books and records. Factual witnesses may be unwilling or unavailable to assist and give evidence.

Further complications arise where the insolvent entity's business and/or assets are sold. Frequently, yet often unintentionally, valuable claims sold for nil consideration as sale and purchase agreements often sweep up unknown intangible assets - which may encompass valuable litigation claims. When the facts of the claim(s) come to light later on following investigation, the rights to the claim(s) have already been assigned. This creates a potential windfall for the new purchaser with no value to the original entity's creditors.

The biggest deterrent to pursuing litigation is often the cost. It is expensive to pursue litigation – and it is even more expensive to lose litigation as the 'loser pays' principle operates in many jurisdictions. Creditors may not welcome the idea of insolvency office holders risking the limited assets within the insolvency to pursue uncertain claims, not least because litigation is also a slow and time-consuming business. Insolvency office holders do not often have the luxury of spending two years fighting litigation claims, whilst trying to simultaneously preserve jobs by realising assets or trade the business in administration.

Is it possible to have a bird in the hand without giving up what might be in the bush?

The short answer is – yes. There are a number of litigation investment companies which specialise in purchasing and then pursuing litigation claims. Such entities will often be willing to pay to purchase those claims.

However, given the risks involved with litigation, asking for a 'buy it now' price for an outright purchase is unlikely to yield maximum value. A third-party litigation investment company has even less information about the claims than the office holders do - which adds additional risks to the already high risks of litigation. All of these risks will inevitably be priced into any outright purchase price. If such risks do not materialise, the assignee gains a windfall down the line (the price of the risk they take).

Often it is better to structure the assignment such that there is a lower upfront purchase price,

combined with a share of any recoveries made. The insolvent company gets to share in the upside of any successful outcome by receiving a percentage of recoveries, whilst still avoiding the risk of the litigation. This works for the assignee as well, because they are not paying upfront whilst values are still uncertain and unrealised.

The trade-off (as with many things) is certainty of money now against the potentially larger amounts of money later. But it is not a black and white choice –an assignment can be structured so that the parties agree (depending on each particular case) how much of the 'birds in the bush' will be sold for certainty now, and at what price. This will be a balancing exercise for the office holder, exercising their judgement whilst working (and of course negotiating) with an assignee to get the right balance.

You keep part of the bird in the hand, and send somebody into the bush on your behalf!

The third-party purchaser will assume the costs of progressing the litigation and, as the assignor, will become the named claimant and therefore assume the adverse costs liability. The prickly bush is not a problem anymore (for the office holder at least), as the risks to the insolvent company and its office holders are significantly reduced (if not eliminated). The consequence is that, if and when the bush bears fruit (or the elusive second bird), that fruit has to be shared - but that is often an attractive trade off in the circumstances.

The importance of evaluating the bush

In order to understand whether an assignment of claims is a worthwhile endeavour; insolvency practitioners must first assess those claims. *In LF2 v Supperstone & anor* [2018] EWHC 1776 (Ch), the court held that office holders have a duty to consider the assignment of claims they do not intend to (or cannot) pursue themselves, unless those claims are "frivolous and vexatious". In fact, the recent case of *Re CGL Realisations Limited* [2022] EWHC 2873 (Ch) demonstrates the value (and indeed the risks) of not assessing litigation properly, as a judgement of more than £100m was awarded in the case, which was larger than the trading surplus and the subsequent realisations of all other assets.

It is not necessarily just the size of the claim that is important, but also how the insolvency office holders assess value and protect the creditors' interests. The case of *Brewer & Anor v Iqbal* [2019] EWHC 182 (Ch) highlighted the importance of documenting decision making and the steps undertaken when assessing the value of intangible assets. In *Brewer*, very little evidence was provided about how an intangible asset was valued before being sold back to the company directors. The office holder was subsequently found to be negligent and ordered to pay the difference between the true value of the assets and value for which they were sold.

Office holders can protect themselves by seeking views in respect of such claims from lawyers, insurers, litigation funding/ATE brokers and third-party litigation funders/investors. Obtaining such views need not be expensive. In particular, insurers, brokers and third-party funders/investors will often assess claims for free and help to 'test the market'. If no one is interested in insuring, funding or purchasing a claim, then the office holders can document those decisions to protect against any potential criticism for failing to pursue a claim. The important thing is to not drop or compromise the litigation until these avenues have been fully explored and considered.

Further, the assignment of claims or the involvement of litigation funders and/or ATE insurers really can provide office holders with the best of both worlds. If the claims succeed, then the company benefits from that success without the risk to its own funds in pursuit of the claims. Likewise, if the claim fails, then it is the third parties and not the company who lose the sums invested and will likely also have to meet (potentially significant) adverse costs.

Litigation funding, assignments and the use of ATE insurance are increasingly common in the UK and offer valuable options to insolvent companies and their office holders. Further, many UK (and non-UK) based funders, investors and insurers are willing to consider backing claims in other jurisdictions. There may be additional layers of complexity and certain jurisdictions which are considered more attractive than others – as a result of perceptions (right or wrong) about the competency and integrity of the judicial systems in those jurisdictions, as well as the availability of enforcement processes. But overseas insolvent entities can increasingly obtain funding, assignment or insurance to assist with the realisation of litigation assets around the world, whilst reducing their own risks.

Conclusion

In summary, there are an ever-increasing number of options available to insolvency office holders to consider when assessing potential litigation claims – and office holders need to be careful to ensure they are properly discharging their duties to consider the best course of action. But if they do, then there is valuable assistance available that has changed the insolvency litigation landscape, which can and will result in insolvent companies achieving higher value and lower risk returns from litigation assets. Working together with third parties means office holders can have (at least a share of) both a bird in the hand and in the bush. ■

> ***There are an ever-increasing number of options available to insolvency office holders to consider when assessing potential litigation claims***