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Update

Liquidators' Personal Liability for Costs

Summary

Liquidators may often consider it necessary to bring proceedings on behalf of the insolvent company to seek to recover assets or obtain compensation on the company's behalf. If that action fails, and the insolvent company does not have the funds to meet any costs order made against it, the liquidator is potentially personally exposed to paying those costs pursuant to a non-party costs order.

This could operate harshly for liquidators. Every piece of litigation has a winner and a loser. If the liquidator is seeking to make a recovery for the company, in the interests of its creditors, should it face personal liability for costs in the event the action is unsuccessful?

Key points

- Liquidators seeking to bring claims on behalf of the insolvent company potentially face a personal liability for costs if that action is unsuccessful.
- This decision clarifies that for such an order on costs to be made, the liquidator must be shown to have acted with impropriety, not merely unreasonably in bringing the claim. "Negligence" in weighing the merits of the action is not enough.
- To protect their own position, liquidators should continue to document the reasons for pursuing the liquidation, supported by written legal advice where appropriate. If funding agreements are in place, liquidators should ensure they provide adequate protection against adverse costs orders.
- The remedy for defendants faced with claims by insolvent companies is to apply for security for costs.
- The case will be of comfort to liquidators, their insurers, and potentially the underlying legal advisors, who could otherwise face satellite litigation.

On 11 November 2015, the Hong Kong Court of First Instance handed down an important judgment clarifying the applicable test to determine the personal liability of liquidators for non-party costs arising out of the pursuit of litigation in liquidations.

In *Super Speed Limited (in Liquidation) v Bank of Baroda* HCCW 273/2012 and *Marshel Exports Limited (in Liquidation) v Bank of Baroda* HCCW 274/2012, the Court determined that the liquidators' conduct in pursuing the litigation must be shown to meet the higher threshold of 'impropriety' as opposed to 'unreasonableness'. This is a key decision for liquidators, who could otherwise face significant personal liabilities if they are unsuccessful in pursing claims on behalf of the insolvent company.

Patrick Perry and Michael Maguiness of Clyde & Co acted for the successful Liquidators in this case and we discuss the decision below.

The Facts

This case arose out of the liquidation of two Hong Kong companies, Super Speed Limited and Marshel Exports Limited.

The Joint and Several Liquidators of the companies applied to have loans advanced by the Bank of Baroda to the companies after the date of the winding-up petitions declared void pursuant to s.182 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance.

The s.182 applications were funded by the petitioner of the companies pursuant to a funding agreement. Under the funding agreement, the funder agreed to bear responsibility for all adverse costs orders, the provision of any security for costs ordered, and to indemnify the companies and the Liquidators in respect of any personal liability for costs arising out of the s.182 applications.

The Liquidators' s.182 applications were heard by the Court of First Instance and dismissed by way of decision dated 4 August 2014 and costs were awarded to the Bank. The Liquidators appealed the decision but were ultimately unsuccessful.

The Personal Claim against the Liquidators

The companies in liquidation did not have sufficient funds to meet the costs order that the Bank had in its favour, and so the Bank issued applications to join the Liquidators and the funder as parties to the s182 proceedings and for non-party costs orders to be made against them personally in respect of the hearing at first instance.

The Bank alleged that the Liquidators had acted improperly and unreasonably in pursuing the s182 applications and either knew or ought to have appreciated that the applications were without justification before they were issued.

The Decision

While the Court accepted that the applicable legal principles relating to non-party costs orders were generally well established, there was one area in relation to applications against liquidators which was not entirely settled.

In the context of liquidators, the Court accepted that different public policy considerations apply when determining whether they should be held personally liable for non-party costs. However, in exercising the discretion to award non-party costs the Court found it was unclear from the case law whether the liquidators must have been shown to act with 'impropriety' or 'unreasonableness' in pursuing the litigation. This issue was significant as 'impropriety' is clearly a much higher threshold than 'unreasonableness'.

Following an analysis of the relevant case law in the area, the Court determined that the correct threshold was 'impropriety' as set out by the English Court of Appeal decision in *Metalloy Supplies Ltd v MA (UK) Ltd* [1997] 1 WLR 1613. Following that decision, the Court determined 'impropriety' was a necessary ingredient to be satisfied before a non-party liquidator would be made personally liable for costs. The rationale for this is (a) the public interest in liquidators being able to perform their duties, (b) the party sued by the insolvent company can protect himself with an application for security for costs, and (c) a security for costs application would avoid the need for expensive satellite litigation such as the Bank's application for non-party costs in this case.

In declining to order non-party costs against the Liquidators, the Court found there was nothing to suggest that the Liquidators' s182 applications were unreasonable, unarguable or fundamentally misconceived particularly as they had sought legal advice prior to issuing the applications. As such, the Court determined that the Bank had failed to establish 'impropriety' or even 'unreasonableness' by the Liquidators in pursuing the s182 applications.

Further, the Court found it was not just to grant the Bank's application against the Liquidators taking into account all relevant considerations. The fact that the Bank had failed to apply for security for costs at first instance weighed heavily against it in terms of the Court exercising its discretion.

However, the Bank was successful in obtaining a non-party costs order against the funder largely due to the provisions of the funding agreement.

Comment

The decision is a positive development for liquidators in Hong Kong as it provides an additional level of certainty regarding personal protection from costs liability when pursuing litigation in liquidations. While pursuing purely speculative litigation or litigation motivated by personal financial gain would likely amount to impropriety, where liquidators have a sound legal basis in pursuing litigation for a genuine purpose it is unlikely they will be held personally liable for costs by reason of the litigation being unsuccessful alone.

Further, the decision is of importance to those sued by the liquidators of insolvent companies as it highlights that the Court will generally take a dim view of any application for non-party costs orders against liquidators personally where no prior application for security for costs has been made.

Further information

If you would like further information on any issue raised in this update please contact:

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Further advice should be taken before relying on the contents of this summary.