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UPDATE

BVI Commercial Court provides guidance on what costs of an application to appoint liquidators will be paid in priority out of the insolvent estate

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A recent decision of the BVI Commercial Court (Justice Michael Green QC) provides useful guidance on what costs an applicant can seek to recover on its application to appoint liquidators in the BVI and their priority in the statutory waterfall.[1]

Background

The decision arose out of an application by the joint liquidators (the **JLs**) of Peak Hotels & Resorts Limited (the **Company**) under rule 199 of the BVI Insolvency Rules 2005 (the **Rules**) for directions on the priority of costs and expenses of the liquidation. The application related to the costs of the petitioning creditor, Jinpeng Group Limited (**Jinpeng**), which applied and was ultimately successful in appointing liquidators over the Company. The costs claimed by Jinpeng were substantial, totalling US$6,270,071.14, and various elements of the sum were in dispute however Jinpeng maintained that they all fell within rule 199(e) of the Rules such that 'the costs of the application on which the liquidator was appointed' had priority over other expenses and floating charges.

Candey Limited, an English law firm which acted for the Company (**Candey**), was permitted to be heard on the application because it had a floating charge over the Company's assets in respect of its fees and its recovery under the floating charge would be directly affected by the amount of Jinpeng's costs held to fall within rule 199(e). Rule 199 sets out the prescribed priority of costs and expenses of a BVI liquidation to be paid out in the order in which they are listed.

On this application, the court was asked to determine whether the following costs properly fell within rule 199(e):

1. the costs of an arbitration directed to be heard (**Arbitration Costs**);
2. the costs of an appeal by Jinpeng on the dismissal of its application to appoint the JLs (**Appeal Costs**);
3. the costs of the application to appoint joint provisional liquidators (**JPLs**) (**JPL Costs**); and
4. the costs of Weil Gotshal & Manges LLP (**Weil**) incurred after 1 November 2015 when the Legal Profession Act 2015 (**LPA**) came into force (**Foreign Lawyers Costs**).

Having determined the priority of these costs and expenses, the court was asked to consider the appropriate means of quantifying these claims whether (i) by the court in the same way as a liquidator's remuneration; (ii) by the liquidators in the same way as any other debt in the liquidation; or (iii) by the court, as it would on a detailed assessment following an order for costs.

[1] *Russell Crumpler and Christopher Farmer (as Joint Liquidators of Peak Hotels & Resorts Limited (in liquidation) v Jinpeng Group Limited* BVIHC(COM) 0116/2014.

Facts

Liquidation applications and appeals

The factual background to the application is complex but, so far as it is relevant, the Company was incorporated in the BVI in 2014 and it sole purpose was to hold shares in a joint venture vehicle which, in turn, held Aman Resorts, a boutique luxury hotel group. On the day after the Company was incorporated, it and one of the joint venture parties, agreed to acquire the Aman Resorts which were held indirectly via a series of holding companies. The relationship between the parties broke down almost immediately after the acquisition.

Jinpeng entered into a memorandum of understanding with the Company (MOU) and a loan agreement providing a loan to the Company of US$35 million on 24 January 2014. The loan was advanced the same day. The MOU contemplated that the loan would be repayable by 24 January 2015 unless the Company and Jinpeng agreed to convert the debt into equity. It was on this basis the Company disputed Jinpeng's application to appoint liquidators.

The breakdown of the relationship culminated in proceedings being issued by the Company in the Chancery Division of the High Court in England and Wales in June 2014 against the joint venture parties and certain creditors of the Company. Candey, and its sister firm, acted for the Company in the London litigation. Pursuant to orders made in the London litigation, monies were paid into court both with respect to a fortified undertaking in damages made in support of various injunction applications and to stand as security for costs of the defendants to the London litigation. As part of those proceedings, Henderson J (as he then was) found the Company's sole director and shareholder, Mr Amanat, to be a '*blatant fraudster who had arranged international fraudulent conveyances … and there was overwhelming evidence that he had acted in bad faith with actual or constructive knowledge of a fraudulent scheme*'.

It was against this backdrop that Jinpeng applied for the appointment of liquidators in the BVI on just and equitable grounds on 17 September 2014 and, on the following day, applied for the appointment of JPLs claiming misconduct and fraud on the part of Mr Amanat as the Company's sole director and shareholder. The Company applied to strike out Jinpeng's application to appoint liquidators on the basis that it was not a creditor of the Company.

Bannister J acceded to the Company's application, in part, by conditionally striking out the application to appoint liquidators on the basis that there was a genuine and substantial dispute which should be resolved pursuant to the arbitration agreement in the MOU. The order conditionally striking out Jinpeng's application provided certain conditions were met which included (i) the Company commencing arbitral proceedings against Jinpeng in Hong Kong; (ii) US$ 35 million being paid into an account in the Company's name in Power Capital Financial Trading UK Limited (Power Capital) (iii) Jinpeng and the Company filing a signed written statement confirming these conditions had been met. The order also included certain freezing injunctions given with the objective of securing at least US$ 35 million pending resolution of the arbitration. Jinpeng was also ordered to pay the Company's costs of Jinpeng's application to appoint the JPLs and its costs of the strike out application. Jinpeng applied for, and was granted, leave to appeal this order in October 2017.

The arbitration was commenced and a statement was filed with the court that US$ 35 million was being held to the Company's account by Power Capital. It transpired that the statement was false and the monies were never deposited with Power Capital. Upon learning this, Jinpeng reinstated its application for JPLs to be appointed over the Company or alternatively for the appointment of receivers together with an application for a freezing order with full disclosure. Bannister J granted a freezing order with limited disclosure and refused all other relief. Bannister J also ordered Jinpeng to pay the Company's costs. Jinpeng successfully applied for leave to appeal Bannister J's order and this appeal was consolidated with its earlier appeal of the conditional strike out order.

The Eastern Caribbean Supreme Court of Appeal allowed the consolidated appeals and awarded Jinpeng its costs of the appeals and the proceedings below, finding that there was no substantial dispute as to the debt on *bona fides* grounds and that the question of the Company's indebtedness should not have been referred to arbitration. The Court of Appeal also found that the learned judge was wrong to have accepted the Company's proposal that the parties should resolve the debt in arbitration and its offer that the strike out of Jinpeng's application to appoint liquidators should be conditional upon the Company commencing

arbitration. Shortly thereafter, Jinpeng's application to appoint liquidators was restored for hearing before Bannister J who appointed liquidators over the Company and made a costs order in the following terms:

> '*that the costs of these proceedings including the Originating Application filed on 18 September 2014and the Originating Application filed on 8 February 2016 be paid out of the Company's assets as costs in the liquidation*'.

The arbitration

While the liquidation applications and appeals were ongoing, the Company commenced arbitration against Jinpeng, amongst others, and which was consolidated with a second, related arbitration. The arbitration was hard-fought, with extensive disclosure and with Jinpeng's principals and a translator flying to London for a three day hearing. The arbitration took place the week following the Court of Appeal's decision reversing Bannister J's orders, rendering the arbitration to a certain extent redundant, a matter the Company probably recognised as it thereafter effectively sought to avoid the arbitration altogether by conceding that it was liable to repay the US$ 35 million loan. Leading counsel for the Company accepted that the Company was effectively '*throwing in the towel*'. Jinpeng proceeded to present its case in any event, including calling live witnesses, because the parties were unable to agree the terms of the award. The tribunal held that in the circumstances it was entirely reasonable for Jinpeng to do so.

The tribunal found in favour of Jinpeng in all of its claims and dismissed all of the Company's counterclaims, awarding Jinpeng US$2,389,914.98 in costs. The arbitration would not have proceeded but for the order of 17 October 2014 by which the striking out of Jinpeng's application to appoint liquidators was made conditional upon the Company commencing arbitration.

Settlement of the London litigation and the JLs' litigation with Candey

Following their appointment, the JL settled the London litigation and, as a result of that settlement, the Company realisable assets amounted to approximately US$13.7 million.

The JLs engaged in significant litigation with Candey with respect to their claims to fees and the security taken in respect of those fees. In short, the JLs concluded that that fee arrangements were entered into when the Company was insolvent such that they were open to challenge.

The background to the litigation with Candey is complex but can be summarised by noting that Candey and the Company entered into a fixed fee agreement by which the Company agreed to pay £940,000 in arrears and a fixed fee of £3.86 million for legal services to be provided in specified litigation (the **Fixed Fee Agreement**). A Deed of Charge was entered into as security for the Fixed Fee Agreement which purported to charge all of the Company's assets with a fixed charge, and purported to charge the monies paid into court as part of the London litigation. This Fixed Fee Agreement culminated in three issues being challenged by the JLs, namely, whether the charge was a fixed or a floating charge, whether Candey was entitled to the full fixed fee of £3.84 million or to the amount it had charged the Company on a time-spent basis (around £1.2 million), and whether the charge was ineffective because the monies in court had been paid out of court as part of the settlement of the London litigation. Candey separately argued that it had a lien over the monies in court and that the success fee was 100% recoverable with the result that if it was successful on these issues, it would have priority over Jinpeng's costs claims.

The result of the various decisions arising out of the applications between the JLs and Candey was that subject to any costs orders in Candey's favour (after set off), Jinpeng's costs that fall within rule 199(e) would have priority over Candey's remaining recoverable fees secured by its floating charge.

It was against this background that Jinpeng was seeking its costs of appointing liquidators out of the insolvent estate of the Company and in which Candey appeared as an interested party.

Legislative Framework

The priority of costs and expenses of a BVI liquidation are set out in section 207 of the BVI Insolvency Act, 2003 and rule 199 of the Insolvency Rules, 2005. The basis for giving priority to the costs and expenses of the liquidation is that they have been incurred on behalf of and for the benefit of creditors generally. It is for this reason that the unsecured creditors effectively share equally and proportionately in meeting those costs and expenses.

The effect of the legislation is that it is only the '*costs and expenses properly incurred in the liquidation*' that will have priority over all other claims in the liquidation in the '*prescribed priority*'. They are also given priority, together with preferential claims, over claims of a floating charge holder such as Candey.

The '*prescribed priority*' is that which is found in rule 199 of the Insolvency Rules and it is mandatory – the court retains no discretion to adjust the order as in England.

Appeal Costs

The first category of costs considered by the court was that of Jinpeng's costs of appealing Bannister J's conditional strike out order. The court found that Jinpeng was entitled to its costs of the appeal on the basis that it would be '*deeply unmeritorious*' for the Company or Candey to suggest that Jinpeng should not have priority for its costs of its appeal where both Bannsiter J and Jinpeng were seriously misled (as to the payment of US$35 million into an account in the Company's name).

Both the Court of Appeal and Bannister J gave orders that the costs of the proceedings should be paid out of the Company's assets, and while it was accepted that these orders did not affect the statutory priority, it was clear that those courts considered those costs should have priority.

The court decided that the costs of the appeal were incurred by Jinpeng in enforcing a class remedy for the benefit of the Company's creditors such that they should be given priority.

JPL Costs

The court considered that the position was similar in relation to this category of costs in that this application was also made for the benefit of the creditors as a whole to protect the assets of the Company and the Court of Appeal immediately re-appointed the JPLs on delivering its judgment.

The court expressed some concern that there was no specific rule relating to the costs of appointing joint provisional liquidators (though there were rules dealing with remuneration and the deposit paid on their appointment) however determined that an application to appoint JPLs is not self-standing – it is made in the same insolvency proceedings. The court found that if the application for JLs to be appointed ultimately succeeds, then the earlier application for JPLs will have been justified and the costs of doing so would be added to the costs of the originating application.

Arbitration Costs

The court accepted that there could not be a much stronger case for including the costs of the arbitration in '*the costs on the application on which the liquidator was appointed*' than in the present case given: Jinpeng was forced to fight the arbitration on the basis of the order to conditionally strike out the application to appoint the JLs which was based on a false premise; the Court of Appeal concluded that Bannister J was wrong to have concluded that there was a *bona fide* dispute on substantial grounds and that he should not have required Jinpeng to establish its debt in the arbitration; and the Company later '*threw in the towel*' at the arbitration itself.

The court held however that while justice may demand that Jinpeng's costs of the arbitration should be given priority (given the arbitration was forced, though potentially necessary to found the application to appoint the JLs), it did not consider them properly to fall in rule 199(e). The court found that if, for whatever reason, the debt has to be established in other proceedings outside of the application to appoint JLs, it was clear that the other proceedings are not within '*the application*' for the purposes of rule 199(e).

Foreign Lawyers' Costs

Given that the court found that the Arbitration Costs (which included Weil's fees) did not fall within rule 199(e), the court had to determine whether Weil's fees in respect of the application to appoint JLs and JPLs and the appeal fell within the rule.

The court was prepared to accept that the fees of Weil prior to 1 November 2015, to the extent they related to the applications to appoint the JLs and the JPLs and with respect to the appeal, were properly to be included in the assessment of costs to take place. This was on the basis that they were incurred prior to the LPA coming into force and that the court was satisfied, on the basis of evidence provided by a Weil partner, that Weil's engagement to act in relation to the BVI litigation was justified.

In relation to the period from 1 November 2015, the court considered itself to be bound by previous authority on the point, *Gargusha v Yegiazarayan* BVIHCMAP2015/0010 and *Shrimpton v Scriven* (BVIHCMAP2016/0031, where the Court of Appeal in *Gargusha* adopted a wide definition of '*acting as a legal practitioner*' for the purposes of the LPA by which the Court of Appeal considered itself bound in *Shrimpton*. The court considered itself similarly bound, such that it decided that Weil's costs of assisting in the BVI litigation after 1 November 2015 were irrecoverable.

The process for quantifying Jinpeng's costs

As noted above, the court was also asked how Jinpeng's costs should be quantified either (i) by the court in the same way as a liquidator's remuneration; (ii) by the liquidators in the same way as any other debt in the liquidation; or (iii) by the court, as it would on a detailed assessment following an order for costs.

The JLs and Jinpeng preferred (ii) with differing levels of enthusiasm, with the JLs voicing expeditious resolution as their overriding concern while Jinpeng preferred it as having an additional advantage of preserving the confidentiality in the detail of its costs. Candey preferred (i) because given the acrimony between the parties, it considered the costs should be carefully scrutinised by the court and that it should be heard on any application.

The court ultimately concluded that (iii) was the most appropriate way forward because it was clear from earlier iterations of the Insolvency Rules (such as the Insolvency Rules of 1949) that it was 'taxed costs' that were given priority and those costs would be assessed on a party and party basis. Given the costs were payable pursuant to the orders made by Bannister J and the Court of Appeal, the proper way to assess them was in the usual way between the Company and Jinpeng by agreement and, failing which, upon taxation by the court.

Conclusion

This decision is a salutory lesson as to what costs properly fall within '*the costs of the application on which the liquidator was appointed*' such that they are recoverable in priorty over other costs of the liquidation, including floating charges. While the creditor applicant has exercised a class right for the benefit of all the creditors who should share in those costs (in that any surplus for distribution will be calculated after those costs have been deducted from the company's realisable assets), the applicant is only entitled to recover specified categories of costs. The court acknowledged that this was a case where justice was on the side of taking a broad interpretation of what constituted '*the costs of the application*' however it also acknowledged that it had no discretion to adjust the order of priorty.

Creditors seeking to appoint liquidators in the BVI would be well-advised carefully to consider what steps are necessary for the appointment of liquidators and whether those steps can truly be said to be costs of the application. For example, it was accepted in argument that the costs of establishing the existence of the debt prior to issuing the application would not be claimable as '*costs of the application*' however the court went on to hold that if the creditor was forced to establish the debt after the application was on foot, at the order of the court, those costs would similarly not be '*costs of the application*'.

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