

Approval of liquidators' fees: When supporting evidence is found wanting

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The Royal Court's latest judgment on an application to approve liquidators' fees demonstrates a strong and thorough approach to protecting creditors.

Lt Bailiff Hazel Marshall QC robustly analysed the application and criticised some elements of the Liquidators' application. However, the solution was pragmatic and considered the risks liquidators face of incurring irrecoverable costs as well as the realities of the market in which insolvency practitioners operate.

From an insolvency practitioner's perspective, this judgment demonstrates that liquidators should take care to submit evidence in support of applications to approve fees, especially when their application deviates from a course which was previously approved by the Court in earlier applications.

Background to the application

In the matter of Company X (in liquidation) [2020] GRC034 is an anonymised judgment, from an application which was heard in private ('in camera') for the approval of the fees of the Joint Liquidators of a Company. Lt Bailiff Marshall considered the matter on the papers in April of this year.

The Company was the holding company of a wide range of other companies in various offshore and onshore jurisdictions. It was placed into administration in 2018, then the administration order was discharged and the Company placed in liquidation.

An application had been made in January 2019 by the Liquidators for approval of their fees and expenses incurred to that date and prospectively for the next six months of the liquidation ending 2 June 2019 (**Initial Period**). Lt Bailiff Marshall approved the Liquidators' incurred fees and their proposed fee rates for the work up to 2 December 2019. Although Lt Bailiff Marshall did not approve a specific figure for the Initial Period, she indicated that the Court would regard fees of around £4,000,000 as reasonable.

The Liquidators returned on 14 August 2019, seeking approval for the fees incurred during the Initial Period and approval for their projected likely fees for the next six months of the liquidation (**Second Period**) ending 2 December 2019. The fees for the Initial Period had been slightly higher than £4,000,000, but after examining the evidence Lt Bailiff Marshall approved the fees incurred. She also indicated that the Court would regard fees of around £4,400,000 as reasonable for the Second Period.

In January the Liquidators made an application that any further considerations of their fees should take place in camera, due to the commercially sensitive nature of the information which would need to be divulged to the Court to explain their activities. The application was granted on the basis that it would harm the interests of the Company if the targets of the Liquidators' claims or recoveries could access information about the Liquidators' intentions.

Overview of the latest application

The latest judgment concerns the third application for approval of the Liquidators' fees. The Liquidators requested approval for:

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1. fees of £2,796,170 plus disbursements incurred in the Second Period; and
2. an increase in the Liquidators' hourly fees for the next six month period of the liquidation to 2 June 2020 (**Third Period**); and
3. indicative approval of estimated fees in the Third Period totalling £4,100,000.

In the preamble to her decision, Lt Bailiff Marshall acknowledged that liquidation is expensive because it requires suitably qualified and experienced professional liquidators to acquaint themselves with the company's affairs from scratch before *'assessing those affairs and taking whatever steps are needed ... to gather in the assets of the company to best overall advantage'*.

However, she went on to emphasise strongly that *'creditors have no effective means of scrutinising, questioning or objecting to [liquidators'] fees'*. Therefore, *'upon an application such as this, which is made ex parte by the Joint Liquidators with no interested party scrutinising or challenging the propositions put forward in support of the relief claimed by them, it is the function of the court to consider the application critically, and with rigour, with a view to seeing that the ultimate interests of the unsecured creditors are protected as far as possible in the circumstances as they appear'*.

Fees for the Second Period

The fees for the Second Period were significantly lower than the £4,400,000 which Lt Bailiff Marshall had previously indicated would be considered reasonable. However, this was because a large amount of work quoted for in the Second Period would actually be taking place in the Third Period.

Lt Bailiff Marshall generally was happy with the minor overspends and approved the majority of the application with the exception of two points:

1. She criticised one workstream titled 'Engagement Acceptance and Control' (**EAC**). There had been a 174% overspend on this workstream at £233,210, compared with £85,023 forecast. No explanation was given for the volume of fees incurred in relation to EAC. Ultimately Lt Bailiff Marshall only approved £100,000 of EAC, giving the Liquidators liberty to apply for the balance to be approved by providing further explanation justifying the sum.
2. She also criticised the inclusion of a large item of disbursements entitled 'other travel expenses' which totalled about £86,000. Airfares, personal car mileage, public transport, rail and taxi had been recorded separately, so it was not clear which expenses were being recorded as 'other travel'. This item was ultimately not approved and further explanation required.

Increased hourly rate for the Third Period

The application split the workstreams for the remainder of the liquidation into two categories: one more complex containing 'investigations' and 'legal strategy and litigation preparation', the other containing the remainder of the work.

The Liquidators sought an increase of 5% on their staff's hourly rates for the general work, and a new rate *'corresponding to 75% of the [firm of Liquidators'] "standard" rates for "complex insolvencies"'* for the more complex category. The rates the Liquidators' staff had been using up to this point were a 37% discount on the firm of Liquidators' standard rates for restructuring advisory work in 2018.

In respect of the 5% uplift for the general work, the Liquidators submitted no evidence and referred generally to:

1. The original rates having been in place since the beginning of the appointment;

2. The fee rates of many other professional advisers engaged by the Liquidators having gone up since that time;
3. The Liquidators' firm's fees having gone up since the 2018 rates which were utilised at the outset; and
4. Moderate fee rises being appropriate from time to time to counter value erosion owing to inflation.

Lt Bailiff Marshall firmly criticised the lack of supporting facts accompanying this argument and judged the first three arguments to have no merit. Referring only to inflation as being a justified argument, she criticised the amount of 5% as having no relation to rates of inflation since the outset of the liquidation. Ultimately an uplift of 2.5% was approved as representing *'the reasonably perceived effects of inflation since the rates were agreed'*.

In respect of the new rates for the more complex category of work, Lt Bailiff Marshall first referred to the *"standard" rates for "complex insolvencies"* for the Liquidators' firm; she described the rate for most senior staff as *'eye-watering'* at £985 per hour, and also referenced the lowest rate of £335. The discount to 75% of those rates which the Liquidators were seeking would therefore run from £740 per hour to £335 per hour.

The Liquidators justified this uplift by reference to:

1. Having little idea of the complexities of this liquidation at the outset, based only on their limited involvement in giving restructuring advice prior to the Company's collapse;
2. The rates charged therefore not being reflective of the tasks being performed;
3. It being market-standard for higher rates to be charged for highly complex work;
4. Those rates reflecting the speculative nature of the work in question; and
5. The risks of non recovery increasing partly due to a diminishing availability of readily recoverable assets.

Lt Bailiff Marshall dismissed the first point, describing herself as *'hugely sceptical'* of the assertion that the Liquidators *'did not appreciate, let alone could not have appreciated, at the outset, that this litigation would be what they would term a "complex" liquidation'*.

She also dismissed the ideas put forward in points 2 and 3 that complex work would justify a higher fee than the same hours by the same person in a less complex context. She pointed out that more complex tasks would naturally take longer, be undertaken by a higher grade of personnel, or require more supervision time by higher-grade personnel and so would cost more without the need for increased rates.

She criticised the division of workstreams into general and complex categories as not being divided by a *'bright line'*. This risked incentivising the liquidators to classify marginal work within the higher-value category.

Lt Bailiff Marshall expressed scorn for references to the Liquidators' firm's "standard" rates, stating: *'I am not particularly impressed by the proposition that these are being discounted by 25%, because a firm's fee rates are, in my experience, largely aspirational – rather like the asking price for a house. I have been given no evidence about fee rates actually negotiated and paid, and I have no doubt that stated charging rates will frequently, even routinely, be negotiated down.'*

Lt Bailiff Marshall calculated the uplift requested in respect of this more complex category of work to amount to around 25% more than the initially approved rates.

Referring to the portion of the application for higher rates in general, Lt Bailiff Marshall pointed to the fact that a large volume of tasks had been pushed from the Second Period into the Third Period. By putting some of these tasks into the complex category, the Liquidators were effectively taking about £1.6m-worth of work which they had previously indicated they were happy to carry out for that amount, then revisiting it to try to secure a higher rate.

Ultimately Lt Bailiff Marshall showed sympathy with the risk of non-recoverability for the liquidators.

She also circled back to the argument that it was standard practice for insolvency practitioners to charge different rates for more complex work. She felt that ignoring these *'market realities'* may *'deter the Joint Liquidators from pursuing the matters in this liquidation with the vigour which they deserve'*.

On that basis Lt Bailiff Marshall ultimately awarded a 7.5% uplift on all the Liquidators' fees. This comprised the 2.5% for inflation and 5% in relation to the complexity related arguments. Although she criticised the lack of evidence behind the arguments for fee increases, she felt that the further costs of asking the Liquidators to gather and submit such evidence were not justified and adopted a pragmatic approach *'to take account of their arguments about increased risk, and to acknowledge (without approving) the effects of market practice, whilst in the context that lower rates were previously accepted'*.

Despite using strongly critical language when referring to the fact that work which had previously been approved at a lower fee-scale would now be undertaken at the uplifted rate due to it being deferred to the Third Period, she felt it would *'really be too complicated'* to adjust the order to account for that.

Judge's closing comments

After the orders were given, Lt Bailiff Marshall gave some guidance for any further applications in the matter:

1. Reports on work done should be divided by grades of staff, rather than as totals or averages which *'do not enable a clear picture to be obtained'*;
2. Reports should also feature the figures from previous periods to allow for easy comparison;
3. There should be some creditor involvement in the process going forward, even if only on a representative basis; and
4. Lastly, she described it as *'high time'* that the Liquidators estimate the likely value of realisations, even if they were qualified or given as a range of possible values.

Overall, Lt Bailiff Marshall demonstrated a pragmatic approach which should nonetheless reassure creditors that the Royal Court will robustly defend their interests.

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