

update

13 June 2008

Friday Facts: Do litigation funders receive priority in a winding up?

In the recent case of Meadow Springs Fairway Resort Ltd (“Meadow”) (In Liquidation) v Balanced Securities Limited (No 2) (“Balanced Securities”) the Federal Court considered whether a litigation funder should receive priority over claims made by secured creditors in a winding up.

Meadow – who built and sold serviced apartments in Meadow Springs, Western Australia – had prior to undertaking the development obtained a valuation on the viability of the project from Colliers International Consultancy & Valuation Pty Ltd (“Colliers”). Relying upon the valuation, Meadow then undertook the project and borrowed sufficient monies to fund the construction. Once the project was completed, Meadow was unable to sell the serviced apartments and as a result ended up in liquidation.

The liquidator sought and obtained litigation funding from IMF (a litigation funder) to bring a claim against Colliers for amongst other things negligence and misleading and deceptive conduct (the “**Funding Agreement**”).

The Funding Agreement provided that should the liquidator receive any settlement sum, it would pay to IMF a management fee, an assessment fee and a success fee of 35% of the settlement sum (the “**Success Fee**”).

The liquidator settled the proceeding with Collier. The secured creditors of Meadow disputed IMF’s entitlement to receive payment from the settlement sum monies it claimed it was entitled to under the Funding Agreement in priority to the secured creditors.

IMF argued that:

- in relation to the Success Fee, it was held on trust by the liquidator for IMF and that IMF had “better equity” than the secured creditors;

- the case of *Re: Universal Distributing Company Limited (In Liquidation)* (“**Re: Universal**”) supported the proposition that there existed an equitable lien in favour of the liquidator which secured the payment of the management, assessment and Success Fee from the settlement sum in priority to the claims of the secured creditors;
- the monies claimed by IMF were payable in priority under the principle of salvage, being a maritime principle that rewards not just compensates services rendered to assist in salvaging another’s property.

The matter was complicated by the fact that the liquidator had not obtained the consent of the creditors to enter into the Funding Agreement as is required by section 477(2B) of the *Corporations Act 2001* (Cth) (the “**Act**”).

Justice Siopis held that IMF should succeed in recovery in priority of the management and assessment fees which it had incurred but declined to allow IMF to recover the Success Fee in priority to the secured creditors.

His Honour considered that the secured creditors had acquired an equitable interest in the company property on the crystallization of their floating charges. That interest included an interest in the Colliers claim which was acquired prior to the date upon which IMF had acquired its equitable interest in the proceeds of the claim.

Justice Siopis did not consider the facts of *Re: Universal* were relevant to the facts in this case and could not fall within the

protection of the liquidator’s lien. He also did not consider the principle of salvage to apply.

His Honour allowed the liquidator’s retrospective application for approval of the Funding Agreement, thereby alleviating the liquidator’s failure to seek approval under the Act. However that relief did not in His Honour’s opinion allow IMF to recover the Success Fee in priority to the secured creditors.

It is likely that IMF will appeal the decision given its tendency to do so in the past in order to clarify the rights of litigation funders.

In the interim, the best protection for liquidators is to ensure that prior to entering into funding agreements, they obtain written approval of both the secured creditors and the unsecured creditors to the terms of the funding agreement and, in particular, the success fee.

For more information

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