

update

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Friday Facts: Liquidators need to seek court approval for litigation funding

Recent developments in the case law dealing with litigation funding have further expanded on the principles which will be considered by the Court concerning the legitimacy of litigation funding.

In the case of *Campbells Cash and Carry Pty Ltd v Fostif Pty Limited*, the High Court found that litigation funding was not an abuse of process which should result in the proceeding being stayed.

However in the recent decision in *Hall v Poolman*, the New South Wales Supreme Court has reconsidered litigation funding. The Court criticised the conduct of a liquidator who entered into a litigation funding agreement where the liquidator knew that almost all of the proceeds of the litigation would go to the liquidator and the litigation funder, with only a negligible return to unsecured creditors.

The proceeding involved the liquidation of the Reynolds Group of companies which owned vineyards and a winery in NSW. The Group owed approximately \$130 million to secured and unsecured creditors. There were insufficient funds to meet the costs of the voluntary administration and winding-up. The only potential assets to be realised were recoveries of voidable preference payments made to the Australian Taxation Office and claims against the directors of the group for insolvent trading. However, there were no funds available to pursue the legal action.

In 2004, the liquidator entered into a litigation funding agreement with a third party. It was

estimated that the maximum recovery from the defendants would be in the vicinity of \$6 million. However, the liquidator's costs in the proceeding blew out.

Justice Palmer noted that having regard to the cost of the proceeding and likely return to creditors, the liquidator should have approached the Court under section 511(1)(a) of the *Corporations Act 2001* to seek directions as to whether he was justified in commencing the litigation in view of the terms of the proposed funding agreement, the costs of the litigation, and the likely return to creditors if the proceedings were successful.

He commented that the "law countenances litigation funding only because it provides access to justice for those who would otherwise be denied justice. If a liquidator's funding arrangements provide no more than a token benefit to the creditors and are in truth a means for the litigation funder and the liquidator to profit, the liquidator should be directed not to proceed."

Justice Palmer added that a liquidator who enters into a litigation funding agreement and promotes expensive litigation resulting in little or no return to the creditors without first seeking the Court's direction runs the risk that the Court will of its own motion,

exercise the power to enquire into the liquidator's conduct conferred by section 536(1)(a) of the *Corporations Act 2001*. In this case, the liquidator did not seek directions from the Court and Justice Palmer held that in the circumstances, the Court should exercise its power enquire into the liquidator's conduct.

Hall v Poolman highlights the importance for liquidators to apply to the Court for directions prior to entering into an agreement with a litigation funder to pursue recovery actions. In the absence of such application, a liquidator runs the risk of being unable to recover their costs and expenses of running litigation on behalf of the company – and potentially, an examination by the Court under 536(1)(a) of the *Corporations Act 2001* as to the liquidators' conduct.

For more information

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