Insurance litigation funding: a brief *overview*

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Insurance Litigation Funding has presented many opportunities for Insolvency Practitioners to take recovery actions on behalf of the general body of Creditors which previously would not have been available to practitioners due to issues such as a lack of funds in the administration and the potential for adverse costs orders against the Practitioner.

What Products are presently available?

With the recent changes in the insurance industry, the players in the insurance litigation funding market are not necessarily those from twelve months ago. John Walker of the Walker Law Group is the Managing Director for the Insolvency Management Fund Pty Ltd ("IMF") which will consider funding matters in Australia, New Zealand and Hong Kong. Michelle Silvers is the Managing Director of Litigation Lending Management Pty Ltd trading as Litigation Lending Services. Other funders of relatively long standing in the market include AON Risk Services Australia Limited, GIO, and GIS Bradstock.

Maintenance and champerty

Funders may only validly become involved in the Insurance Funded Litigation market if their products do not offend the common law doctrines of maintenance and champerty. Accordingly, arrangements, which involve maintenance and/or champerty, are void as being contrary to public policy.

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Ensuring the champerty and maintenance rules are not infringed

One of the first reported cases in Australia on this topic is the decision of Drummond J in *Re: Movitor Pty Ltd v Sims* (1996) 19 ACSR 440.

The case concerned an agreement between Lumley General Insurance Ltd (*"Lumley"*) and the liquidator of Movitor Pty Ltd (*"Movitor"*) whereby Lumley agreed to support the liquidator in prosecuting an insolvent trading action against Movitor's former directors and its holding company.

Lumley agreed to:

a. Pay 50% of the legal costs incurred by the Liquidator in prosecuting the action; and
b. Indemnify the Liquidator against 50% of all costs, expenses and damages awarded against him in the proceedings.

The Liquidator had the support of creditors who were prepared to assist with the remaining 50% of the required funding.

The funding agreement provided for Lumley to receive a premium of 12% of the net amount recovered after reimbursement of all expenses financed by Lumley and the contributing creditors during the course of the litigation. If there was no recovery from the action, no premium was payable to Lumley and it would not receive any reimbursement of the costs financed by it.

Drummond J initially considered whether Lumley had an interest in the litigation sufficient to justify what would otherwise be unlawful maintenance. Drummond J viewed the existence of such an interest as essential if Lumley's participation in the litigation was to be considered lawful. In this regard, Drummond J was relying upon the principals set out by Lloyd LJ in *Browntown Ltd v Edward Moore Imbucon Ltd* (1985) 3 All ER 499 at 509.

As Lumley had no commercial or other interest in the litigation other than an interest created by the arrangement itself, Drummond J found that prima facie, the agreement was void and contrary to public policy.

Although Drummond J found that the arrangement between the Liquidator and Lumley was at common law champertous, he also gave consideration to any statutory exception to maintenance and champerty and in particular, the Liquidators statutory power of sale or disposition of company property under s. 477(2)(c) of the *Law*.

The funding assistance provided by Lumley under the arrangement with the Liquidator was not unlawful because it formed part of a transaction pursuant to which the Liquidator disposed of property of the company, that is, part of the prospective proceeds of the litigation. Drummond J also found that the potential proceeds of the company's proposed action under the insolvent trading provisions of the law was *"property of the company"* as that term is used in s.477 (2)(c) of the *Law*.

Other decisions since *Movitor* have considered issues such as the level of involvement of a funder in court proceedings, the level of the premium and the types of actions for which funding is available (see for example: *UTSA Pty Ltd v Ultra Tune* (1997) 1 VR 667 and *Re: Tosich Construction Pty Limited* (1997) 23 ACSR 126).

Who Can Apply for Funding?

Prima facie the funding arrangement is unlawful and in breach of the rules against maintenance and champerty. As such, it is necessary for an applicant to be able to rely upon a statutory power of sale or disposition of common property. Liquidators clearly have this power pursuant to to s477(2)(c) as evidenced in the cases of *Movitor* and *Tosich*. The position with respect to other types of external administration are as follows:-

a) Provisional Liquidation

A liquidator of a company appointed provisionally has the powers that a liquidator of the company would have under s477(2) of the *Law* [see s472(4)(b)]. Provisional liquidators therefore enjoy the same exception to the rules against maintenance and champerty. It is unlikely however, that a provisional liquidator would commit to ongoing litigation until such time as he or she was permanently appointed liquidator.

b) Voluntary Administration

An administrator is empowered under s437(1)(c) of the *Law*, during the period of administration, to dispose of the company's property (subject to the rights of any charge holder). It would be unlikely that an administrator would seek to commence lengthy litigation before the second creditor's meeting, although the position may be different if it is proposed that the company enter into a Deed of Company Arrangement.

c) Deed Administrator

In *Re William Felton & Co Pty Ltd* (1998) 16 ACLC 1294 Bryson J held in obiter that litigation funding agreements entered into by a deed administrator will not infringe the rules against maintenance and champerty.

d) Receivers

Typically, receivers have powers under their instrument of appointment, to sell or dispose of the company's property. These powers, however, are not statutory and do not provide an exception against the rules of maintenance and champerty. Under s420(2)(b) of the *Law* however, the receiver has, in addition to the powers conferred by the instrument, conditional power to "dispose of property of the corporation".

Accordingly, it is likely that a receiver will be able to enter into a funding agreement without infringing the rules against maintenance and champerty.

e) Scheme Administrators

The powers of a scheme administrator will be defined in the scheme, the administrator's contract and by general law. The appointment of a scheme administrator is only effective once the court order sanctioning the scheme of arrangement has been delivered to the ASIC [s411(10) of the *Law*]. As there is no legislative grant of power to a scheme administrator, it does not appear that a scheme administrator will have any legal capacity to assign actions of the company the subject of the scheme and therefore will be unable to apply for funding.

f) Controlling Trustees

A controlling Trustee appointed to the estate of a bankrupt has powers to "*deal with Debtors' property in any way that will, in the opinion of the Trustee, be in the interests of the creditors*" [s190(2)(d) of the *Bankruptcy Act* 1966 (Cth)]. Given the wide powers granted to Trustees (particularly after the 1997 *Bankruptcy Act* (Cth) amendments which now provide that a Trustee does not have to seek creditor approval before inter alia disposing of assets of the bankrupt) a Trustee in bankruptcy clearly has the same, if not wider, powers than a liquidator. As such, a funding agreement entered into by a Trustee will not infringe the rules against maintenance and champerty.

g) Trustees of Deeds of Assignment

The property of a Debtor in respect of a Deed of Assignment (including action) rests in the Trustee on the execution of the Deed of Assignment [s299 of the *Bankruptcy Act 1966* (Cth)].

By virtue of s231(3) of the *Bankruptcy Act 1966* (Cth) a Trustee of a Deed of Assignment has the same powers as a Trustee in bankruptcy identified in s134 of the Bankruptcy Act 1966 (Cth) and in particular the power to "*sell all or any part of the property of the bankrupt*".

Trustees of Deeds of Assignment therefore are empowered to sell actions of the Debtor and, by necessary implication, to enter into a funding agreement without infringing the rules against maintenance and champerty.

h) Trustees of Deeds of Arrangement

Similarly, Trustees of Deeds of Arrangement are empowered to "*sell all or any part of the property of the Debtor*" [s237(2) of the *Bankruptcy Act 1966* (Cth)]. Trustees of Deeds of Arrangement may therefore legally assign the actions of the Debtor and, again by necessary implication, may enter into funding arrangements without infringing the rules against maintenance and champerty.

i) Trustees of Compositions

Unfortunately for Trustees of Compositions, the power of sale granted to a Trustee in bankruptcy pursuant to s134 of the *Bankruptcy Act 1966* (Cth) does not apply to Compositions under Pt X.

Trustees of Compositions may not legally assign actions of the Debtor utilising the statutory power of sale exemption. If a Trustee of a Composition wishes to enter a funding agreement, he or she will need to satisfy the other exceptions to the rules against maintenance and champerty such as "the genuine commercial interest" exception. Failing this, the Trustee of the Composition will be precluded from lawfully entering into a funding agreement.

What considerations are relevant to the Insurer?

The following is a non-exhaustive list of matters which should be addressed in any application for funding:-

1. The nature of the claim;
2. Details of the appointment;
3. Likely Defences available to the Defendant/s;
4. Personal details of the Directors or Bankrupt

Apart from the documentation supplied with respect to the above headings, any other documentation which may be relevant, including Reports as to Affairs and Circulars to Creditors should be included in the Application for Funding.

Should application be made to more than one funder?

It is arguable that if Application is to be made for funding, it should be made to more than one insurer in a "*competitive tender*" process. There is probably now a duty on Liquidators and Trustees to seek the most favourable offer of funding which will provide the highest return for Creditors. Arguably the best way to demonstrate that this duty has been fulfilled is to apply to more than one Insurer for funding and let the results of the Applications speak for themselves.

The only extra expense to the administration associated with applying to more than one Insurer is the expense associated with copying the "brief" for the Funding Application more than once. Despite the view expressed by some Insurers that they would prefer to be the only funder to which Application is made, if the Insurance Litigation products are to survive, they must be able to compete in the market place. PL