Third party litigation funding: credit where it's due?

Update prepared by Nicholas Fox (Partner, Cayman Islands) and Harry Rasmussen (Associate, Cayman Islands)

In the recent decision in *Re Platinum Partners Value Arbitrage Fund L.P. (In Official Liquidation)*[1], the Grand Court of the Cayman Islands clarified the circumstances in which it would sanction the use of a third party litigation funding agreement in a liquidation context. This case is particularly interesting due to the Court's' treatment of secured creditor interests, where the proposed funder's fees were to be paid out of charged assets in priority to the rights of those secured creditors.

Snapshot of the case

Following an application made by the Joint Official Liquidators (the **JOLs**) of Platinum Partners Value Arbitrage Fund L.P. (the **Master Fund**), the Grand Court of the Cayman Islands (the **Court**) sanctioned the JOLs to enter into a third party litigation funding agreement (the **Funding Agreement**) with LL Finance LLC (**LLF**). The Funding Agreement was to be used by the JOLs to fund both (a) investigations into potential claims and; (b) any subsequent litigation of appropriate claims.

This decision is particularly noteworthy because the application was opposed by White Rock Properties LLC (**White Rock**), one of fifty-four creditors who claimed to hold non-possessory security interests over the assets of the Master Fund, including over claims which were to be covered by the Funding Agreement (collectively the **PSCs**). The Funding Agreement contemplated that LLF's fees would be paid from recoveries under such claims, in priority to the PSCs.

In determining the case, the Court had to balance the estate's need for funding against the impact on the interests of secured creditors, whose assets would normally fall outside of the insolvency estate.

The parties' positions and the issues before the Court

The JOLs submitted that, due to the limited funds available to them, the only way in which relevant claims and litigation could be pursued (and therefore recoveries made for the benefit of the Master Fund's stakeholders, including the PSCs) was if they obtained third party funding, covering both investigations and potential future litigation.

Of the fifty-four PSCs, White Rock was the only one who actively opposed the JOLs' application, albeit that the remaining PSCs did not consent to the JOLs' application either.

White Rock did not oppose the JOLs obtaining funding for the purpose of pursuing litigation *per se*, but took issue with certain terms of the Funding Agreement; its core objection being that LLF would be entitled to be paid sums as expenses in the liquidation in priority to the secured claims of the PSCs and that the

[1] Unreported, 31 October 2018.

JOLs had provided insufficient information to allow it to determine whether its rights as a creditor of the Master Fund were adequately protected.

In granting the JOLs' application, the Court considered:

- the impact of the Funding Agreement on the PSCs and whether the Court should sanction the Funding Agreement in the absence of the PSCs' consent (the **PSC Issue**);

- whether it should sanction the entry into the Funding Agreement more generally (the **Discretion to Sanction Issue**); and

- whether the Funding Agreement was unlawful for champerty and maintenance.

The PSC Issue

In seeking to persuade the Court on this issue, the JOLs asserted that:

1. the Court had jurisdiction to sanction the Funding Agreement notwithstanding that it imposes a first ranking security interest on recoveries potentially subject to the PSCs' security interests. This was because, without some funding, there would be no ability to pursue claims and therefore generate funds from which the secured claims of the PSCs could be paid; and

2. the sums payable to LLF represented costs incurred by liquidators in realising charged assets. As such, they were payable ahead of the secured creditors' claims.

    a. The JOLs relied on various common law authorities to support this argument, including the seminal English case of *Re Berkeley Applegate (Investment Consultants) Ltd*[2] which established that the Court has discretion to allow an insolvency practitioner to recover an allowance for their costs of realising trust property in their control ahead of the claims of beneficiaries. It was also submitted that the decision in *Berkeley Applegate* was relevant to the award of an allowance of costs out of realised charged property, because the Deputy Judge who had decided the case had referred to and considered a number of earlier authorities dealing with this issue.

    b. The JOLs also relied upon the Australian High Court decision *In Re Universal Distributing Co Ltd (in liquidation)*[3]. In that case, the assets realised by the liquidator were insufficient to meet the liability owing to secured creditors. It was held that the expenses which had been reasonably incurred in the care, preservation and realisation of the property charged to those creditors could be deducted from the fund realised by the liquidator. This decision was followed and summarised by the Australian High Court in *Stewart v Atco Controls Pty Ltd*[4] as follows:

> *"The principle from Universal Distributing [can] be shortly stated as: a secured creditor may not have the benefit of a fund created by a liquidator's efforts in the winding up without the liquidator's costs and expenses, including remuneration, of creating that fund first being met. To that end equity will create a charge over the fund in priority to that of the secured creditor."*

In examining the terms of the Funding Agreement, the Court accepted that it had jurisdiction to order that costs incurred by liquidators in realising charged assets are payable out of those assets ahead of the secured creditor's claims. It went on to conclude that whilst the costs paid to LLF would be significant, those costs represented the price payable to ultimately realise the proceeds from relevant claims.

The Court accepted that the JOLs had not behaved unreasonably and that there was not a realistic prospect of alternative funding being made available on more attractive terms. The Court noted the JOLs'

---

[2] [1989] 1 Ch 32

[3] (1933) 48 CLR 171

[4] (2014) 252 CLR 307

concerns that there was a risk of limitation periods expiring soon on some of the Master Fund's claims, and as such there was an urgent need to put the funding in place. Therefore, the Court found that giving directions requiring further information to be provided to White Rock or allowing White Rock more time to make funding proposals was not justifiable.

Discretion to Sanction

The JOLs sought sanction of the exercise of their powers provided for in Part 1 of Schedule 3 to the Companies Law (2018 Revision) (as amended)[5], which may only be exercised with the Court's sanction.

The Court accepted that, in considering this application, it should take into account and apply the following principles considered in the judgment in *Re DD Growth Premium 2X Fund*[6]:

1. the Court must consider all the relevant evidence;
2. the Court must consider whether the proposed transaction is in the commercial best interests of the company, reflected *prima facie* by the commercial judgement of the liquidator;
3. the Court should give the liquidator's views considerable weight unless the evidence reveals substantial reasons for not doing so;
4. the liquidator is usually in the best position to take an informed and objective view; and
5. unless the Court is satisfied that, if the company is not permitted to enter the deal in question, there will be better terms or some other deal on offer, the choice is between the proposed deal and no deal at all.

The JOLs submitted that the evidence demonstrated that the Funding Agreement was in the best interests of the Master Fund. White Rock did not challenge the JOLs' submissions on this issue, and the Court accepted them.

Champerty and Maintenance

The JOLs submitted that a litigation funding agreement made between an official liquidator and a funder, who has no interest in the liquidation as a creditor or shareholder, will only contravene the principles of champerty and maintenance if the funder is in a position to control or exercise a significant degree of influence over the conduct of the litigation. Where the Court is asked to sanction a litigation funding agreement, it will be carefully scrutinised to ensure that it does not confer such rights upon the funder.

The JOLs relied on the decision in *In A Company and A Funder*[7] which, they submitted, established that the crucial issue was whether or not a funding agreement had the tendency to corrupt public justice, undermine the integrity of the litigation process and give rise to a risk of abuse. In *A Company and A Funder,* the Court clarified seven features of a funding agreement that were likely to have a significant impact on determining such an issue, namely:

1. the extent to which the funder controls the litigation;
2. the ability of the funder to terminate the agreement at will or without reasonable cause;
3. the level of communication between the funded party and the solicitor;
4. the prejudice likely to be suffered by a defendant if the claim fails;
5. the extent to which the funded party is provided with information about, and is able to make informed decisions concerning, the litigation;
6. the amount of profit that the funder stands to make; and
7. whether or not the funder is a professional funder and/or is regulated.

In light of these features, the JOLs submitted that the Funding Agreement did not contravene the principles of champerty and maintenance. White Rock did not challenge the JOLs' submissions on this, and the Court accepted them.

---

[5] In particular: paragraph 1(power to bring or defend any action or other legal proceedings); paragraph 3 (power to dispose of any property of the company); paragraph 7 (power to deal with all questions in any way relating to or affecting the assets or winding up of the company); and paragraph 9 (power to raise or borrow money).

[6] [2013 CILR (2) 361]

[7] Unreported, 23 November 2017.

Comment

The judgment in this case records the practical approach adopted by the Cayman Islands judiciary when considering whether to sanction the use of a litigation funding agreement where there are potentially competing claims between the funder and secured creditors.

The decision is also a useful reminder for liquidators considering third party litigation funding agreements, of the principles the Court will adopt in considering whether to sanction, and the focus placed by the Court on protecting the rights of secured creditors of the company.

Contacts

Nicholas Fox
Partner, Cayman Islands
+1 345 814 9268
nicholas.fox@mourant.com

Harry Rasmussen
Associate, Cayman Islands
+1 345 814 9214
harry.rasmussen@mourant.com