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INSOLVENCY LITIGATION UPDATE - FEBRUARY 2018

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In our update this month we take a look at two cases dealing with funding issues in matters involving insolvent companies and applications for security for costs.

The first case involves an application for details of non-party funders and funding arrangements for the purpose of making a security for costs application. The second involves the question of whether an After the Event (ATE) insurance policy could be taken into account in a security for costs application and, if so, whether it would provide the defendant with sufficient protection.

Both cases highlight key issues insolvency practitioners (IPs) need to be aware of when considering commencing, or indeed continuing with, litigation on behalf of an insolvent company.

- Details of non-party funders and funding arrangements can be disclosed
- After The Event (ATE) insurance policy can be considered in a security for costs application, but it may not be enough to defeat it

Details of non-party funders and funding arrangements can be disclosed

The Chancery Court has confirmed that disclosure of the identity of non-party funders and details of the funding arrangements can be provided to a counter-party to enable an application for security for costs to be made against that non-party. Although this decision was handed down in July 2017 the judgment has only recently been published.

Background

In the matter of Hellas Communications (Luxembourg) (Hellas) the respondents applied to court for disclosure of the identity of the funders of the litigation being brought against them by the liquidators of Hellas.

The respondents intended to make a security for costs application. They argued that the court had an inherent jurisdiction to make orders for disclosure of the identity of third party funders, to give effect to its power to grant security for costs under Part 25 of the Civil Procedure Rules (CPR). An application for such security could not be made until the identity of the third party funder was known.

The liquidators alleged that the court did not have jurisdiction to order disclosure of the identity of the funders, or any other material providing details of the funding arrangements and should not therefore order disclosure. If an order had to be made it should be for disclosure of such terms and conditions of the funding arrangements that would enable the court to decide, at a preliminary hearing, whether the person against whom an application for security for costs would be made "has contributed or agreed to contribute to the claimants' costs in return for a share of any money or property which the claimant may recover the proceedings." The liquidators argued that any disclosure must be subject to stringent confidentiality provisions that would protect their interests.

Decision

The court was satisfied that it had the power to make orders that would in turn allow an application for security for costs under the CPR Part 25 to be made. The jurisdiction existed even though no costs order had yet been made against the non-party funders. This must be correct in light of the fact that CPR 25.14 expressly permits an order for security for costs to be made against a third party before any determination of the merits of the dispute.

The court held that in exercising its inherent power any order should ensure that the interests of the claimants - in protecting the confidentiality attaching to both the identity of their funders and the terms of the funding arrangements - are preserved in so far as is possible. This was especially so in light of the fact that the security for costs application itself had not yet been heard and may still be refused.

The evidence confirmed that the liquidators were reliant upon third party funders (who

included but were not necessarily limited to creditors of the company in liquidation) to pursue the litigation in question. The liquidators had argued that the terms of the financing therefore fell outside of the ambit of CPR 25.14. Any contribution to the costs was not in return for a share of the proceeds of the litigation, rather it was to assist in the recovery of money which would (hopefully) enable a distribution to be made in the liquidation (which may or may not include the creditors in question). The respondents, on the other hand, had maintained that CPR 25.14 did extend to persons who may be creditors of an insolvent company and who are funding litigation by liquidators, with a view to recovering some part of their debt through the insolvent company.

The court was satisfied that the application was properly made and was one that had a realistic prospect of success. However, in order to protect the liquidators' interests, details of the funding arrangements were to be limited to a confidentiality club, with the recipients providing undertakings as required.

Comment

IPs need to be mindful of this decision. Where a claim is being funded by third party funders there is a real risk that the identity of the funders and the terms of the funding will have to be disclosed to a defendant where the issue of security for costs is being considered. In cases involving insolvent companies this will no doubt be the case, and may well be so even before the security for costs application itself is made.

IPs will need to ensure that funders are aware of this risk, as they may well be required to disclose details of their involvement in funding the litigation when they do not wish to do so (even though disclosure is likely to be limited to those who sign up to a confidentiality ring). This could result in reluctance on the part of potential third party funders to provide funds to allow an insolvent company to pursue a claim, especially when the funder is a creditor of the insolvent company.

The position is similar when it comes to litigation where insolvent claimants have put in place After The Event (ATE) insurance, to cover the defendants costs in the event the claim fails. As we consider in our review of the Premier MotorAuctions case (below), the existence and terms of the ATE policy will be relevant when the court considers a security for costs application. Details of the policy will therefore need to be provided, albeit that may be in a redacted form and to those who are subject to confidentiality provisions.

After The Event (ATE) insurance policy can be

considered in a security for costs application, but it may not be enough to defeat it

In Premier MotorAuctions Ltd & Another v Price Waterhouse Cooper & Another the Court of Appeal has looked again at the issue of whether ATE insurance can constitute adequate security for an opponent's costs, should the insured be ordered to pay those costs.

Background

The claimants were companies (a car auction business and a company selling registration plates for the DVLA) in liquidation. They alleged that the defendants, a bank and an accountancy firm, had entered into an unlawful means conspiracy to force the companies into administration so that their business and assets could be sold at an undervalue. The claimants' claim was worth in excess of £45 million.

The liquidators (on behalf of the claimants) had obtained ATE insurance for some £5milllion, although under its terms the policy could be avoided for non-disclosure or misrepresentation and it did not cover payment of an order for security for costs. The defendants were provided with redacted copies of the ATE policies but the claimants refused to obtain deeds of indemnity from the insurers. As a result the defendants sought security for their costs in the sum of £7.2 million.

At first instance the court held that the ATE insurance in question could be taken into account when deciding whether the requirements of the Civil Procedure Rules governing security for costs (CPR 25.13) were met. In particular it relied on the ATE policies in deciding whether the claimants would be able to pay the defendants' costs if ordered to do so. As it had no reason to believe the ATE policies would not cover the defendants' costs, it had no jurisdiction to make an order for security.

The defendants did not accept that the policies constituted sufficient security. They asserted that the ATE insurance was no more than a contingent asset and therefore could not be taken into account. Furthermore, in determining whether the ATE insurance was relevant, the judge should have asked whether it gave the defendants substantially the same security as payment into court, a bank guarantee or a deed of indemnity from the insurers. They appealed to the Court of Appeal.

Court of Appeal Decision

The Court of Appeal held that, despite there being little appellate authority on the issue, an appropriately framed ATE insurance policy could, in theory, be an answer to an application for security for costs. If the ATE policy provided "sufficient protection" to a defendant there would be no reason to believe that a claimant would be unable to pay the defendant's costs if ordered to do so, and consequently the court would have no jurisdiction to award security at all.

The fact that an ATE policy is in place will not be enough on its own. The key question is whether the terms of the ATE policy will provide the defendant with sufficient protection.

In the case of the policies providing the ATE insurance in this case, the fact that there were no anti-avoidance provisions was conclusive in the Court of Appeal reaching its decision that the policy did not provide sufficient protection. The Court of Appeal accepted that insurers will avoid paying out on policies if they consider it right to do so. Factual evidence would be critical, the case would turn on the factual evidence given by the claimants' key witnesses. If the case failed it was conceivable that the court's factual findings would be inconsistent with what the insurer had been told at the outset. If that was the case the likelihood of the ATE policies being voidable would, in turn, be increased.

The ATE policy in question was not, therefore, deemed sufficient to meet the security being sought by the defendants in the case. The claimants were, consequently, required to provide security in the sum of £4 million.

Comments

This decision will no doubt have a significant impact on the insolvency industry and its ability to pursue claims. By their very nature insolvent companies are unlikely to be able to meet a defendant's costs of litigation in the event of an unsuccessful claim, and ATE insurance policies are one way around this problem.

Earlier decisions had gone some way to dissuading defendants from making a security for costs application once they knew the claimant had ATE insurance. Now, following the Court of Appeal decision, the fact that an ATE insurance policy is in place is unlikely to put defendants off making such an application.

The fact that an ATE policy may not be enough to stave off a security for costs application

will almost certainly have an impact on the decision insolvency practitioners need to make when deciding whether to bring - or continue with - proceedings on behalf of insolvent companies.

See also our earlier insight on this case.

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