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Third-party litigation funding in insolvency

MARIUS NASTA

REDRESS SOLUTIONS

Third-party litigation funding – the funding of a claim by a third party in exchange for a share of the damages – is making significant in-roads in both domestic and international litigation. It is also increasingly used by insolvency practitioners (IPs) in an insolvency scenario. This article explores two aspects of third-party funding in an insolvency scenario: the reasons for which an IP is an ideal client for a funder and some of the myths that have developed about a third-party litigation funder's role in an insolvency.

The IP is an ideal client for a third-party litigation funder

An IP is a funder's ideal client for several reasons.

First, it may well be that the IP has no other choice but to secure funding from a third-party litigation funder. Typically, the IP has an estate with no money in it and a substantial claim against the party that ruined the business of the company to which he has been appointed. Securing funds from creditors in order to bring a claim against a third party

REDRESS SOLUTIONS

Marius Nasta is the chief executive of Redress Solutions. He can be contacted on +44 (0)207 495 3900 or by email: mnasta@redresssolutions.co.uk.

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is extremely difficult. Third-party litigation funding is the IP's 'only game in town' in such a situation.

Second, IPs are seasoned professionals with significant business experience and a clinical approach to bringing claims. Unlike many lay claimants, the IP is not 'in love' with the claim; if he has an estate without any viable method of recovering funds for the benefit of the creditors, he will close down the insolvency without wasting any further money. If he puts forward a claim for funding, it is usually one with very good prospects of success, and most importantly, an avenue for recovering the amounts awarded by a court after the judgement has been obtained.

Third, IPs are used to leverage their contacts with other professionals whose services are required to secure the best interests of the creditors. In particular, IPs tend to have excellent contacts with law firms carrying out commercial litigation, who can be relied upon to do a competent job of ensuring that the claim is presented to the best effect. Typically, lawyers will have had a long association with the IP or his firm and will be very keen to keep that connection by providing an excellent service.

Fourth, the liquidator will wish to ensure that neither he nor his firm is exposed to the risk of having to pay adverse costs and will protect himself with an After the Event (ATE) insurance policy. An ATE policy is a policy of insurance under which a party to litigation insures against the risk of losing his case and having to pay the opponent's costs. It is common for payment of the premium on the policy to be both deferred until the end of the case and for the cost of the premium to be insured as part of the cover, so that no premium is paid if the action is lost. If the claim is funded, the IP will not have to worry about ATE and its premium since the funder will usually offer the IP an indemnity for any adverse costs on the claim.

Finally, IPs can be relied on to be efficient claim managers. As far as the funder is concerned, once he has carried out his review and decided that the case deserves to be financed, he can get the funding documentation executed with the minimum of fuss and has a claim that will be conducted with the maximum of efficiency and the minimum need for intervention on his part.

For all reasons set out above, the IP is one of the funder's preferred clients – a 'marriage made in heaven' (a phrase not normally associated with IPs or litigation funders).

Third-party litigation funders in an insolvency scenario – myths and realities

As in non-insolvency scenarios, and perhaps due to the spectacular growth of third-party litigation funding, a number of myths have developed about how funded claims will impact on the IP's role when bringing a claim against a third party. One of the myths consists in believing that once funding is in place, the funder will appoint his own lawyers and will then handle the claim himself. Another myth consists in believing that a funder is prepared to finance unmeritorious claims, relying on his financial strength to overwhelm the opposition.

In reality the truth is the complete opposite. The funder wants to see a claim presented to him that has intrinsic merits and is being conducted by a competent legal team so that once he has decided to defray the legal expenses, he only needs to be brought up to speed with developments in the case and to be consulted on large expenditures on disbursements. If the funder had to 'run' every single case he would need a staff as big as a major law firm and the whole business would be economically unviable. In several jurisdictions, such as England and Wales or Canada, such wholesale interference would be unlawful as offending against the rules governing maintenance and champerty.

Funding unmeritorious claims serves nobody's interests – the claimant will be disappointed, the funder will lose money and his shareholders will lose faith in the funder's ability to select claims and run a viable, profitable and long term business. A professional funder's reputation is as important as the funds he has under management. ■