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Litigation funding – be up-front, or risk being “inquired”? The practical consequence of the *Hall v Poolman* appeal

Reconstruction & insolvency

The recent decision of the NSW Court of Appeal in *Hall v Poolman* has clarified the circumstances in which a liquidator may be justified in accessing litigation funding to prosecute recovery proceedings.

In reaching its decision, the NSW Court of Appeal considered the scope of the power granted to courts to supervise the conduct of liquidators and the role of the liquidator in serving the public interest.

Background

The case arose from a decision by a trial judge to order an inquiry, under section 536 of the *Corporations Act*, into the conduct of a company's liquidators. The conduct in question was a decision by the liquidators to bring and prosecute proceedings against the directors of the company, using funds provided by a litigation funder, in circumstances where it was clear that the likely return to creditors would be minimal, with the majority of any amount recovered paying the costs of the liquidator and the litigation funder.

The role of liquidators

In finding for the liquidators, the NSW Court of Appeal has confirmed that, regardless of the actual return to creditors, there may be a wider public interest that is served in liquidators commencing and continuing recovery proceedings.

Supervision of liquidators

The NSW Court of Appeal gave a broad interpretation to the power given to the court under section 536 of the *Corporations Act* to inquire into the conduct of a liquidator.

Conduct that can be the subject of such an inquiry is not limited to conduct establishing a lack of faithful performance of a liquidator's duties or a failure to comply with the law or requirements of a court. The power extends to an inquiry into any conduct of a liquidator in respect of which a complaint has been made. There is no requirement that the complaint be a formal complaint. A complaint or criticism made during the hearing of a proceeding being prosecuted by the liquidator may be sufficient.

Litigation funding

The decision in *Hall v Poolman* clarifies that liquidators who have obtained the fully informed approval of creditors, are not required, as a matter of course, to seek the approval of the court prior to entering into a litigation funding agreement. It also confirms the circumstances in which a liquidator may pursue litigation with the aid of a litigation funder, even if there is little or no likelihood of recovering more than the liquidator's costs and expenses and the funder's fees.

Those circumstances are:

- (a) the liquidator has incurred costs in preliminary investigations and in creditors' meetings;
- (b) the liquidator considers that the prospective benefits to creditors justify further investigation in which more costs and expenses will be incurred;
- (c) there are no assets, in the absence of litigation, to pay the costs already incurred;
- (d) the pre-litigation costs were either necessary or reasonably considered to be justified because of the prospective benefits to creditors;
- (e) the litigation costs themselves were reasonably incurred and proportionate to the prospective benefits (including not only possible direct benefits to creditors but also benefits derived through the reimbursement of the liquidator's fees and expenses); and
- (f) the litigation funding agreement is not on manifestly unreasonable terms.

Issues of fact, degree and timing may render it difficult, in practice, to determine that these criteria are satisfied. In some cases, in order to satisfy a liquidator's duty of skill, care and diligence, the prudent course for a liquidator may be to seek directions from the court.

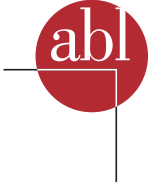
If a liquidator were to enter into a litigation funding arrangement without satisfying these criteria in circumstances where the anticipated total recovery for creditors was minimal, the likelihood of the litigation funding arrangement being approved by the court is lowered. Further, the risk is increased that a court would conduct an inquiry, under section 536, into the liquidator's conduct. Obtaining the prior approval of creditors to the litigation funding agreement will not nullify the risk of an inquiry.

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