Grand Court Approval Of Proceedings Brought By Companies In Liquidation, Litigation Funding Agreements And Contingency Fee Arrangements

In an unreported judgment in ICP Strategic Credit Income Master Fund Ltd. delivered on 4 April 2014, Mr Justice Jones has helpfully confirmed and clarified Cayman Islands law and procedure in respect of applications by liquidators for approval to (i) bring proceedings in the name of the company, (ii) enter into litigation funding agreements with litigation funders, and (iii) enter into contingency fee agreements with the liquidators' lawyers.

ICP Strategic Credit Income Master Fund Ltd., 4 April 2014, Cayman Islands Grand Court

Facts

The Joint Official Liquidators sought the Grand Court's authority to bring proceedings in courts in the United States, in the names of the ICP master and feeder funds over which they had been appointed, against a major global bank and a well-known international law firm. Subject to Court approval, the proceedings were to be funded pursuant to the terms of a contingency fee agreement made with New York lawyers. The Judge observed that the points of law raised by the application were not novel, but at the request of the applicants he put his reasons in writing on the basis that it would be helpful to insolvency practitioners in this jurisdiction generally.

Sanction to bring proceedings

Pursuant to section 110(2)(a) of the Companies Law (2013 Revision), the power to bring (or defend) legal proceedings in the name of the company is only exercisable by its official liquidators with the sanction of the Court. The Judge confirmed that in deciding whether or not to sanction the commencement of such proceedings, the Court must be satisfied as to two matters.

- First, that there are one or more causes of action which have a reasonable prospect of success. In this regard the Judge stated that *"[a]s officers of the Court, official liquidators are expected to behave in an exemplary manner and to perform their duties and exercise their powers fairly. The Court will not allow its official liquidators to threaten or commence litigation speculatively as a means of extracting a settlement from a party against whom there is no genuine cause of action or no evidence from which to infer that a possible cause of action has any real prospect of success".*

- Second, that it is in the financial interests of the stakeholders for any good, arguable cause of action to be

pursued. The Judge noted that *"[a]lthough it may ultimately be to [stakeholders'] advantage if litigation is successfully prosecuted and a judgment obtained in favour of the company, there are concomitant risks. An adverse outcome is likely to result in the depletion of the funds which would otherwise be available for distribution, even if the litigation can be conducted in a jurisdiction in which the loser will not be ordered to pay the winner's costs. There may be circumstances [which were said not to arise on the facts in ICP] in which the downside risks of litigation would fall upon the creditors, whereas the upside benefit would go, in part, to shareholders who bear no corresponding risk. It follows that the Court's decision to sanction the commencement of litigation can never be entirely divorced from questions about how and by whom it will be financed"*.

Sanction of litigation funding and contingency fee agreements

The Judge drew a distinction between three types of litigation funding arrangements, which he defined (narrowly) as follows:

- *Litigation Funding Agreements* between a liquidator and a funder (who may or may not be an existing stakeholder in the liquidation), by which the funder funds the prosecution of litigation in the name of the company in return for (and only in return for) a share of any proceeds recovered from that litigation.

- *Contingency Fee Agreements* between a liquidator and a foreign law firm, by which the law firm agrees to prosecute a cause of action belonging to the company on terms whereby the firm's remuneration will be based on a share of the proceeds of the claim, and will therefore only be paid if the litigation is successful.

- *Conditional Fee Agreements* between a liquidator and any law firm, by which the law firm is paid on the basis of discounted hourly rates in any event (and can therefore be said to fund the litigation to the extent of the discount), but with an entitlement to an uplift in excess of its "normal" hourly rates if pre-determined success criteria in the litigation are achieved.

Litigation Funding Agreements

Having reviewed various decisions of the English Courts on this topic and the issues of maintenance and champerty, including in particular the decision of Coulson J in *London & Regional (St. George's Court) Limited v Ministry of Defence* [2008] EWHC 256, the Judge summarised the present state of Cayman law on the subject of litigation funding agreements entered into by liquidators as follows:

- In considering whether a funding agreement is unlawful on grounds of maintenance or champerty, the question is whether the agreement has a tendency to corrupt public justice. The Court will adopt a flexible approach and will generally decline to hold that an agreement under which a party provides assistance with litigation in return for a share of the proceeds is unenforceable. The rules against champerty, so far as they have survived, are primarily concerned with the integrity of the judicial process in the Cayman Islands.

- An outright sale by an official liquidator, by way of legal assignment, of a cause of action where the price is expressed to be a percentage of the proceeds of the action is a valid exercise by the official liquidator of his

statutory power to sell the company's property.

- An assignment of a percentage of the proceeds of a cause of action pursuant to a litigation funding agreement is also a valid exercise of the official liquidator's statutory power to sell the company's property, provided that the funder is given no right to control or interfere with the conduct of the litigation. The Court will carefully scrutinise the terms to ensure that no such right is conferred on the funder directly or indirectly.

- A right of action or the proceeds of a right of action vested in the official liquidator personally, such as a preference claim, cannot be sold under the statutory power to sell the company's property as this would amount to an unlawful surrender by the liquidator of his fiduciary power which is contrary to public policy.

Contingency Fee Agreements

The Judge went on to make the following remarks in relation to contingency fee agreements:

- Contingency fee agreements with Cayman Islands attorneys or counsel are contrary to Cayman Islands public policy, void and unenforceable, and the Court therefore obviously cannot authorise an official liquidator to enter into such an agreement.

- Contingency fee agreements entered into with foreign attorneys or counsel are not void on public policy grounds, provided that the agreement is to be performed wholly outside the Cayman Islands in a foreign country where its performance will be lawful and permissible in accordance with applicable local law and rules of professional conduct.

- Any such contingency fee agreement must comply with the provisions of Order 25 of the Companies Winding Up Rules, including the requirement that it be governed by Cayman law and that any disputes arising under it are subject to the exclusive jurisdiction of the Cayman Courts. It should normally take the form of a detailed commercial contract, rather than a simple engagement letter, even if such a letter might be sufficient to comply with the applicable foreign rules of professional conduct.

- A contingency fee agreement must not fetter a liquidator's fiduciary power to exercise complete control over the manner in which the litigation is conducted, including preserving the liquidator's final and exclusive right, subject to Court sanction, to make settlement decisions.

- Contingency fee agreements should expressly address the scope of the law firm's reporting obligations, which will typically require it to prepare or assist in the preparation of reports to creditors/shareholders, the liquidation committee and the Court. The lead lawyers may be expected to appear in person in connection with sanction applications made to the Court in connection with the conduct or settlement of the litigation.

- The Court will always be concerned to ensure that the termination provisions are appropriate. The law firm (or the funder under a litigation funding agreement) should have no right to terminate the agreement and

cease undertaking legal work (or paying legal fees) without the consent of the liquidator or sanction of the Court. Conversely, the law firm should have no right to continue to prosecute a claim which the liquidator no longer considers to be meritorious, or to insist on being paid on a time spent basis if the liquidator gives instructions for the action to be discontinued.

- Lastly, the Court will need to be satisfied that appropriate due diligence has been conducted by the liquidator as to the capital adequacy of the law firm being retained on a contingency fee basis (or the funder under a litigation funding agreement). The Court may expect to see contractual representations and warranties from the law firm that it has the financial and human resources to enable it to conduct the litigation to a conclusion. Conversely, the Court will also need to be satisfied that the liquidation estate is in a position to meet any financial obligation to pay out of pocket expenses incurred by the law firm in respect of the litigation.

Conditional Fee Agreements

In relation to conditional fee agreements, which were not proposed in *ICP* and in relation to which no decision therefore needed to be made, the Judge merely observed that in *Quayum v Hexagon Trust Company (Cayman Islands) Limited* [2002] CILR 161 such agreements with Cayman Islands attorneys and counsel had been held to be enforceable, provided that they were approved by the Court. He also noted that in *Latoya v Attorney General* (unreported, 14 February 2012), the Cayman Islands Court of Appeal, while holding that no amount payable by a successful plaintiff to its lawyers under a conditional fee agreement could be recovered from a defendant on taxation, had otherwise declined to comment on the correctness of the decision in *Quayum* because it had been unnecessary to do so on the facts and would have been inappropriate given that the subject has been referred to the Law Reform Commission.

The judgment did not refer to the unreported decision in *DD Growth Premium II X Fund* dated 23 October 2013 (which Justice Jones may not have been referred to as it was handed down between the date of the application and the date of the judgment in *ICP*). In *DD Growth* the Chief Justice, while expressing the view that legislative intervention was necessary in this area, had applied and extended the principles set out in *Quayum* when sanctioning liquidators to enter into a conditional fee agreement with Cayman Islands attorneys to recover pre-liquidation redemption payments made by a fund.

Conclusion

Justice Jones' judgment in *ICP* provides a welcome and helpful guide to the Court's approach to liquidators' applications for sanction to commence proceedings, to the type of litigation funding and contingency fee agreements which the Court may be willing and able to sanction, and to the principal terms which the Court will expect such agreements to contain or not contain. The report from the Law Reform Commission on the subject of conditional fee agreements will also be welcomed by both practitioners and the judiciary, but it is not currently clear when that will be provided.

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