LH AG ADVOCATES AND SOLICITORS

Litigation Funding for Insolvent Companies

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26 August 2020

Litigation funding, otherwise known as litigation financing, allows a party who lacks the finances to have its day in court through third-party funding. While litigation funding remains an obscure notion in Malaysia, it has progressively developed in other jurisdictions such as the UK, Australia, Hong Kong and Singapore. In some of these jurisdictions, there even exist specialised litigation financing firms to provide for the need.

In the current COVID-19 climate, litigation funding will likely become a hot topic. As businesses grapple with the global economic slowdown, corporate insolvencies will be on the rise — and so, too, will the need for funding to pursue insolvency-related claims.

Litigation funding for insolvent companies

One of the many assets that an insolvent company may have can include a contingent asset such as a cause of action against another party.

However, a liquidator appointed over an insolvent company may be restrained from pursuing a meritorious claim due to lack of available funds. In general, a liquidator may seek for such funds from the contributories of the company.[1] However, in practice, it is more common to seek for funds from creditors. That being said, it is not always the case where a creditor is willing to throw good money after bad.

As a result, a liquidator may end up forgoing a meritorious claim that could potentially increase the assets of an insolvent company. More so where the cause of action exists in a different jurisdiction. The uncertainty of the procedure, costs to employ foreign representation and currency exchange involved will make any reasonable liquidator think twice about initiating a lawsuit in a foreign jurisdiction.

This is where the option of litigation funding can play an important role as a means for an insolvent company to access justice, for the ultimate benefit of the creditors as well as contributories of an insolvent company.

How litigation funding works

In exchange for advancing funds to enable the commencement a lawsuit, funders will seek a percentage of returns from the judgment sum or settlement of a lawsuit. It is common for a funder and a litigant to enter into an agreement in respect of this.

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[1] Companies Act 2016, s 435(1)

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Given that funders rely on the success of a case to obtain a return, funders will not finance weak or unmeritorious lawsuits. Prior to deciding whether to fund a lawsuit, funders will, as part of their due diligence, assess the merits of a claim and the likelihood of recovery.

Ethical concerns of litigation funding

Litigation funding goes against the common law doctrines of champerty and maintenance. Champerty is a form of maintenance, where a third-party pays some or all of the litigation costs in return for a share of the proceeds. Maintenance refers to an unconnected third-party assisting to maintain litigation, by providing, for example, financial assistance.

The common law condemns champerty and maintenance as there is a fear that a champertous maintainer might be tempted, for his own personal gain, to inflame the damages, to suppress evidence, or even to suborn witnesses.[2] It seeks to protect the purity of justice and to preclude frivolous litigation.

Setting regulations for litigation funding

However, with proper regulations in place, both statutory and voluntary, it is possible to address the ethical concerns of litigation funding.

In the UK, for example, there is an Association of Litigation Funders established to govern the conduct funders. The association has a self-regulated “Code of Conduct for Litigation Funders” (**Code**), which sets out the standard practice and behaviour for funders.

One of the key aspects of the Code is that funders are not allowed to take control of the lawsuit or any settlement negotiations. Funders are also prohibited from causing the litigant’s lawyers to act in breach of their professional duties. This helps to keep the roles of funders, litigants and their lawyers separate at all times.

In addition, the Code provides that funders must behave reasonably and may only withdraw from funding in specific circumstances. If there is a dispute about termination or settlement of a litigation funding agreement, a binding opinion of an independent Queen’s Counsel, who has been either instructed jointly or appointed by the Bar Council, must be obtained. This helps to balance the relationship between funders and litigants.

Legality of litigation funding in Malaysia

While the issue of litigation funding has not been deliberated by our courts to date, it is arguable that litigation funding is not permitted in Malaysia. This is mainly because the common law doctrines of champerty and maintenance are applicable here.[3]

Further, when the Arbitration Act 2005 was amended in 2018, there was a proposal to introduce third-party funding of international arbitration as part of the amendments. However, the proposal fell through. Had it been included, it would have opened the door for further development of litigation funding in Malaysia.

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2 *Re Trepca Mines Ltd (No 2)* [1963] Ch 199 (CA) at 219-220
3 Civil Law Act 1956, s 3

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Development across the Causeway

Prior to 2017, third parties in Singapore, as in Malaysia, were prohibited from funding an unconnected party's litigation under the doctrines of maintenance and champerty. However, following amendments made to the Civil Law Act in 2017, certain third-party funding agreements may be valid if the funding relates to prescribed dispute resolution proceedings and the third-party funder meets certain prescribed requirements.

Interestingly, even before the amendments in 2017, the Singapore High Court had, in 2015 in *Re Vanguard Energy Pte Ltd*,[4] allowed a funding agreement between the liquidators of the company and three of its shareholders, where the three shareholders agreed to bear the company's costs of pursuing its claims, and in exchange, part of the fruits of the claims would be assigned to them.

Since then, the Singapore High Court has in *Solvadis Commodity Chemicals GmbH v Affert Resources Pte Ltd*[5] as well as *Trikomsel*[6] approved funding agreements entered into between the liquidators of the insolvent companies and commercial third-party litigation funders.

Recently, with the enactment of the Insolvency, Restructuring and Dissolution Act, which came into force on 30 July 2020, liquidators and judicial managers may now assign to third parties the proceeds of actions involving undervalue transactions, unfair preferences, extortionate credit transactions, fraudulent and wrongful trading or delinquent company officers. In this regard, the requirement to seek court approval or authorisation of the committee of inspection in respect of third-party funding agreements has now been statutorily provided for.

Conclusion

Given the benefits of litigation funding and the access to justice it provides, it will be extremely advantageous if this was also available in Malaysia. In the context of insolvent companies, liquidators would value the support of third-party funding to right the wrongs perpetrated against the company and to pursue meritorious claims for the benefit of its creditors.

In view of the prevalence of litigation funding and its progressive development in other jurisdictions, it is foreseeable that it will only be a matter of time before a test case comes before the Malaysian courts. One thing is for sure — it will certainly be interesting to see the growth of litigation funding in Malaysia.

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4 [2015] 4 SLR 597 (HC)
5 [2018] SGHC 210 (HC)
6 (HC/OS 989/2018) (unreported) (HC)

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