A novel approach

A RECENT SUPREME COURT DECISION CONFIRMS THAT PLAINTIFFS ARE NOT LIMITED TO PROVIDING SECURITY FOR COSTS IN CONVENTIONAL FORMS. BY SHAUN CLEMENT

Proceedings involving plaintiff companies in financial distress can stall when a defendant applies for security for its costs. Once a defendant establishes that there is reason to believe that the plaintiff will be unable to pay the defendant's costs if its defence succeeds, the court has a wide discretion as to whether to order security be provided and, if so, the quantum and form of that security. The court will balance the plaintiff's right to bring an action against the potential prejudice to a defendant if it may be unable to recover its costs of a successful defence. (For the avoidance of doubt, a plaintiff may also seek security for its costs against a defendant in relation to a cross-claim. This article, however, will focus on the standard defendant-led action.)

Conventionally, a plaintiff provides security by paying money into court or providing a bank guarantee. Those secure funds are then readily available to satisfy any future costs orders in favour of the defendant.

Two Supreme Court judgments confirm that parties are not limited to providing security equivalent to the conventional forms of security. Therefore, one impediment to insolvency litigation may be lessened – that is, the burden of needing to tie up substantial capital for the duration of a proceeding. That will be music to the ears of liquidators weighing up the prospect of commencing bet-the-farm litigation while juggling the ongoing administration of the company.

On one hand, that approach ought to increase the ability of a financially distressed plaintiff to obtain funding for and to pursue more claims. It may also make the Australian litigation funding market more accessible and attractive to overseas litigation funders. On the other hand, defendants must exercise fresh vigilance to ensure that novel forms of security will adequately protect their client's interests if that security needs to be called on.

The decision in *DIF*

The plaintiffs in *DIF III Global Co-Investment Fund LP and Anor v BBLP LLC and Ors* [2015] VSC 484 *(DIF)* were based overseas with no assets in Australia. The defendants applied for security for their costs. In response to the application, the plaintiffs unsuccessfully sought to provide security by means of a deed of indemnity which was to be executed by a UK-based insurer, AmTrust Europe Limited. The crux of the plaintiffs' proposal was that if an adverse costs order was made in favour of the defendants, then the defendants could rely on the deed of indemnity to claim payment from the insurer. Neither party could identify any Australian case where the issue had been litigated.

Lansdowne AJ held that a deed of indemnity provided by a third party insurer could be an adequate form of security

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in some circumstances.[1] However, she determined that the plaintiffs' proposal was not appropriate on the evidence provided.

Accordingly, Lansdowne AJ held that the "interests of justice require in my view cash deposit or bank guarantee".[2] That view was formed, in part, because of her view that the conventional forms of security were superior to the plaintiff's proposal.[3] The plaintiffs appealed that decision.

The decision in *APCH*

Before judgment being delivered in *DIF,* the Supreme Court of Victoria was asked to consider a near identical application in *Australian Property Custodian Holdings Ltd (in liq) v Pitcher Partners* [2015] VSC 513 (*APCH*).

The plaintiff in *APCH* proposed to provide security by way of a deed of indemnity executed by the same UK-based insurer as in *DIF,* AmTrust Europe Limited. It appears that the insurer learned from its experience in *DIF* and, as a result, the plaintiff provided more complete evidence in *APCH*.[4]

Ierodiaconou AJ reached a contrary conclusion to *DIF.* By distinction to the plaintiff's position in *DIF,* in *APCH*:

- there was direct evidence as to the financial position of the UK-based insurer to the effect that the insurer had very substantial assets, and that the insurer was unlikely to default on the deed[5]
- the plaintiff had offered to pay into Court funds sufficient to cover the defendant's potential costs of enforcing the deed[6]
- the deed was irrevocable, unconditional and directly enforceable against the insurer.[7]

Ierodiaconou AJ held that although the deed of indemnity was "disadvantageous" to the defendants compared to the usual forms of security, that disadvantage was not unreasonable in the circumstances. She held that the deed "will adequately protect the defendant".[8] Accordingly, Ierodiaconou AJ ordered that the plaintiff provide security by way of a deed of indemnity executed by the UK-based insurer, in addition to paying $20,000 into Court by way of security for the defendant's estimated costs of enforcing the deed of indemnity. The defendant appealed against that decision.

DIF and *APCH* appeals

The appeals in *DIF* and *APCH* were heard simultaneously by Hargrave J. On 19 July 2016 he delivered judgments permitting the respective plaintiffs to provide security by way of deeds of indemnity, together with the payment into Court on account of the defendants' estimated costs of enforcing the deeds of indemnity.[9]

The respective plaintiffs submitted that they should be permitted to rely on assets located in foreign jurisdictions if the defendants would be able to enforce a costs order in that foreign jurisdiction.[10] The plaintiffs provided evidence of the theoretical enforcement procedures and reiterated their proposal to pay cash into Court by way of security for the defendants' estimated costs of enforcing the deeds of indemnity, including registering any Victorian judgment in the UK.

The plaintiffs also pointed to developments in the UK in support of novel forms of security. For example, in *Versloot Dredging BV v HDI Gerling Industrie Vesicherung AG* [2013] EWHC 658 (Comm) the plaintiffs sought an order allowing them to provide security by way of a deed of indemnity from an insurer instead of providing a bank guarantee. There, the Court held that "there is no magic in the provision of security from a first-class London bank" and that security can be given by a promise proffered by "a truly creditworthy entity".[11]

The respective defendants submitted that the plaintiffs bore a "practical onus" in persuading the Court to make an order for a novel form of security, and that any assessment required a comparison between the proposed form of security and the usual forms of security. For example, in *Nylex Corporation Pty Ltd v Basell Australia Pty Ltd* [2009] VSC 97, Mandie J refused to accede to the plaintiff's request to provide security by way of an insurance policy.[12] In that case, his Honour noted that the plaintiff had given no evidence that the insurers would be unable to provide an Australian bank guarantee.

Hargrave J held that a plaintiff is permitted to propose "security in a form least disadvantageous to it".[13] If the plaintiff's proposal is in a novel form of security, then the Court's overarching consideration is "whether the proposed form of security is adequate to achieve its object as security".[14]

However, the Court should not undertake any sort of comparison exercise between different forms of security.[15]

SNAPSHOT

- Practitioners acting for financially distressed plaintiffs should turn their mind to what forms of security are most advantageous to their client and not limit themselves to conventional forms of security.
- In two cases the Supreme Court of Victoria has upheld novel proposals to provide security by way of a deed of indemnity given by an overseas-based third party.
- The Supreme Court's judgment, together with developments overseas, suggest that there may soon be a growth in novel proposals of security for costs requiring vigilant assessment by practitioners acting for defendants, and by the Court.

His Honour upheld the appeal in *DIF* and dismissed the appeal in *APCH*.

Counterbalancing sequels

The plaintiff in *Australian Institute (Vic & Tas) Pty Ltd v Australian Institute of Fitness (NSW) Pty Limited & Ors [No 2]* [2016] VSC 625 (Australian Institute) unsuccessfully sought to rely on the appeal judgment in *DIF*. The plaintiff proposed to provide security for costs by means of a deed of indemnity to be provided by a related third party. That third party, Nexus Institute Pty Ltd (Nexus), apparently had sufficient assets to meet any potential costs order against the plaintiff.

Vickery J distinguished *Australian Institute* from the appeal in *DIF* because:

- Nexus did not have the same reputation and financial standing as the insurer in *DIF*
- Nexus was not independent of the plaintiff and shared common directors and shareholders
- due to the protracted nature of litigation between the parties, there was "an unacceptable risk that Nexus might not pay on demand or may delay payment of the costs" to the plaintiff.[16]

As a result, the Court ordered that security be provided in the usual form, that is, by way of payment into Court.

In *Bodycorp Repairers Pty Ltd v GDG Legal Pty Ltd* [2017] VSC 200 a personal undertaking offered by a sole director was held to be an inadequate form of security. By contrast, the County Court of Victoria in *GM Fascia & Gutter Pty Ltd v Trailer Trash Franchise Systems Pty Ltd* (Unreported, County Court of Victoria, Morrish J, 28 July 2017) permitted security to be provided by way of a personal undertaking from a related person. On appeal, the Court of Appeal said that an order for payment into court or a controlled money account or by procuring a bank guarantee would have been more consistent with the *Civil Procedure Act*, but did not overturn the County Court's orders as to the form of that tranche of security.[17]

What next?

Practitioners advising plaintiffs and litigation funders should consider what forms of security will be most convenient to their clients. Security in the form of cash or cash equivalents will remain the simplest form of security and the preferred option for most defendants. If a plaintiff intends to propose a novel form of security, then steps should be taken at an early stage to ensure any application for security can be met promptly, for example, by preparing and agreeing a form of deed of indemnity with the third party funder.

One option immediately open to plaintiffs is to obtain a deed of indemnity from a financially secure and independent third party. The appeal judgment in *DIF* provides a useful checklist of considerations to that approach.

However, the Court will also need to consider, on a case-by-case basis, the circumstances of proposed indemnifying third parties. Not all parties will carry the same clout as the insurer in *DIF* and *APCH*.

Practitioners acting for defendants must also be attentive to ensure that their client obtains real protection for their costs. That may include monitoring any change of circumstance in the third party's financial position to ensure that the third party remains capable of meeting any costs orders. It may also be prudent to consider building into orders additional check measures, such as ongoing disclosure of financial statements, to ensure a defendant continues to be protected, especially in lengthy litigation.

Going forward, plaintiffs may seek to build on the framework in *DIF* and *APCH* to propose more novel and commercially advantageous forms of security. For example, courts in the UK have considered applications in relation to providing security by way of "after-the-event" insurance policies covering possible adverse legal costs. Those courts have held that there is "no reason in principle" why "after-the-event" insurance policies cannot be relied on as complete security for costs.[18] In the recent decision of *Petersen Superannuation Fund Pty Ltd v Bank of Queensland Limited* [2017] FCA 699, the Federal Court rejected a plaintiff's proposal to provide security in the form of an "after-the-event" insurance policy provided by AmTrust Europe Limited. It is very likely that another plaintiff will attempt to provide security by way of another "after-the-event" insurance policy in the near future.

There is likely to be rapid development in the law of security for costs. If UK case law is any guide, then domestic courts are likely to take an open-minded approach to any further novel forms of security put forward. ■

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1. Snowden, DJ and Boone, E, A Leader's Framework for Decision Making, *Harvard Business Review,* November 2007; See also www.youtube.com/watch?v=s8SayvnfQi0.
1. [2015] VSC 484 at [129].
2. Note 1 above, at [128].
3. Note 1 above, at [103].
4. [2015] VSC 513 at [50].
5. Note 3 above, at [32].
6. Note 3 above, at [58].
7. Note 3 above, at [50].
8. Note 3 above, at [56].
9. [2016] VSC 399 and [2016] VSC 401.
10. See, for example, *Maxim's Caterers Limited v Magnona Pty Ltd (No 1)* [2010] FCA 450; *Berry v Innovia Security Pty Limited* [2014] FCA 357.
11. [2010] EWHC 658 (Comm) at [10] per Clarke J.
12. [2009] VSC 97 at [29] and [30].
13. [2016] VSC 401 at [38].
14. Note 13 above, at [38] and [63].
15. Note 13 above, at [65].
16. [2016] VSC 625 at [57].
17. [2017] VSCA 293 at [61].
18. *Michael Philips Architects Limited v Riklin* [2010] EWHC 834 (TCC) at [49]. See also, eg, *Harlequin Property (SVG) Ltd & Anor v Wilkins Kennedy (a firm)* [2015] EWHC 1122 (TCC); *Greenclean Waste Management Ltd v Leahy* [2015] IECA 97.