In This Issue

While Australian lawyers are prohibited from entering into contingency fee agreements with their clients, non-lawyers are free to fund a plaintiff’s litigation in exchange for the percentage of any verdict or settlement. This so called ‘litigation funding industry’ is essentially unregulated and has spread to other parts of the world. The author and two of his partners have developed a comprehensive proposal to ensure effective oversight of the funders. That proposal is described in this article.

Litigation Funding in Australia - A Proposal for Reform

About the Author

Stuart Clark is a partner in Clayton Utz, resident in the firm's Sydney office. The focus of Stuart’s practice is the defence of class actions and other complex litigation. He also provides strategic crisis management advice to corporations and government agencies. Stuart publishes and lectures extensively, both in Australia and overseas, in relation to class actions and complex litigation. His work in this field led to his appointment in 2010 as an Adjunct Professor in Macquarie University Law School. He has been a member of the IADC since 1994 and has served on the Boards of both the IADC and the Foundation. He can be reached at sclark@claytonutz.com.

About the Committee

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Peter Pliszka
Vice Chair of Newsletters
Fasken Martineau DuMoulin LLP
ppliszka@fasken.com
For a country where class actions were unknown to the law before 1994 it is extraordinary that Australia has not only developed a vigorous class action 'industry' but is now also exporting some of its ideas to the rest of the world.

While Australian lawyers are prohibited (at least for now) from entering into contingency fee agreements with their clients non-lawyers, including publicly listed corporations, are free to do so. What's more there is virtually no regulation of these arrangements or effective oversight of those engaged in the funding industry. While lawyers are the most regulated profession in Australia, the litigation funders have until now avoided any real scrutiny, let alone a comprehensive proposal for their regulation.

Third party litigation funders agree to finance a claimant's litigation in exchange for a percentage of any verdict or settlement received by the claimant. The percentage varies although it generally ranges from 20 - 40%, depending on a range of factors. However, this is not the end of the story - some litigation funders also charge a so called 'management fee' on top of the contingency percentage and most will require the claimant to assign the benefit of any costs order that might be made by the court at the end of a trial. Australia uses what is sometimes called the 'English Rule' for costs which means that the loser is usually ordered to pay the winners costs in addition to the damages that are awarded. In this context the term 'costs' includes both the lawyers professional fees and the out of pocket expenses incurred in running the case. As a result, litigation funding has become a very profitable business in Australia and has attracted a range of funders, including publicly listed corporations and foreign entities as well as smaller local participants.

For many years there was uncertainty as to the legality of these arrangements as some argued that they offended the common law rules against maintenance and champerty. However, this was finally resolved in favour of the funders by the High Court of Australia, the country's ultimate court of appeal, in Campbell's Cash and Carry Pty Ltd v Fostif Pty Ltd (2006) 229 CLR 386. Since that decision, there has been steady growth in the number of claims financed by litigation funders. The principal areas of growth has been complex torts or business disputes and class actions.

While the litigation funders maintain the pretext that they are merely providing funding to enable litigants to engage a lawyer to pursue their claim and that the conduct of the proceedings is a matter for lawyer and client the reality is very different. In most cases the litigation funder, sometimes in conjunction with a law firm but often alone, will identify and investigate a potential claim before going out and promoting that claim in what is known as a 'book build'. In simple terms this involves promoting the claim in the media and signing up potential class members to a funding agreement. While in the past this involved each claimant entering into a written agreement with the funder and a retainer with a lawyer this has now often been reduced to the simple click of an 'accept'
button on a web site. The conduct of the litigation is then effectively assumed by the funder who will nominate a representative plaintiff and work with the lawyers to determine how the case will be run and often settled.

Despite this extraordinary shift in the litigation landscape, Australian governments have taken a largely hands-off approach to the regulation of the litigation funding industry. Indeed, when it appeared that funders were providing financial services and required a licence under the Corporations Regulations 2001 (Cth) they were almost immediately exempted from the requirements. Additionally, they are not bound by the professional rules that govern lawyers in their dealings with the Court. As a result, litigation funders operate with minimal regulatory oversight.

It will come as no surprise to lawyers and others working in this area that the profitable nature of the funding industry and the current largely unregulated environment have created a number of problems - these include:

- An increase in the number of filed and threatened claims, as there is a larger resource pool available to potential claimants and their lawyers.
- Conflicts of interest arising between the litigation funders, lawyers and claimants, as a consequence of the fact that litigation funders exert a significant degree of control over strategic decisions concerning the litigation process and any settlement.

This can result in the claimant's interests being relegated to secondary status behind the litigation funder's profit objective, weakens the role of the lawyer and calls into question who the lawyer's 'client' really is.

- A potential increase in prolonged litigation, as the typical structure of funding agreements may deter claimants from accepting settlement offers, and encourage litigation funders to draw out the litigation process, and thereby increase costs.
- Conflicts of interests arising between funded group members and non-funded group members with the increasing use of funded open class actions, often at the expense of the non-funded group members.
- Lawyers potentially side-stepping the prohibition on entering into contingency agreements by creating litigation funding vehicles and/or acting in matters funded by entities in which they have an indirect financial interest;
- The advent of 'fly by nighters operating in the Australian market, meaning claimants and defendants cannot be confident that a litigation funder will remain solvent, or have sufficient financial resources to pay legal fees, out of pocket expenses and any adverse costs order in the event the litigation is unsuccessful;
- The absence of an adequate requirement making disclosure of key information to claimants who avail
themselves of a litigation funder’s services.

While these problems and the unregulated nature of the industry have regularly been the subject of submissions to government and media commentary there has not, until recently, been any real proposals for reform. However, in a paper prepared for the US Chamber Institute for Legal reform entitled *An Oversight Regime for Litigation Funding in Australia*, three Clayton Utz partners, Nicholas Mavrakis, Matthew Daley and Stuart Clark, have proposed a comprehensive regulatory scheme. Its aim is to address these consequences and provide effective regulatory oversight within the existing Australian financial services regulatory regime. Their proposal involves:

- **Licensing:** A litigation funder would be required to hold a licence of a specific class. Entry into the Australian market would be limited to those funders that meet the licence requirements.

- **Enforcement Authority:** The Australian Securities and Investment Commission (ASIC) would be the designated regulatory body responsible for the administration and enforcement of this licencing regime. ASIC would be empowered to exercise the powers and discretions it presently exercises over the Australian Financial Services Licencing (AFSL) regime.

- **Special Conditions:** As a licence holder, a litigation funder would be required to comply with the specific conditions of its licence. The conditions would, at a minimum, address the following matters:
  - **Capital Adequacy Requirements**—A licenced litigation funder would be subject to prudential supervision to ensure the funding vehicle has sufficient capital in Australia to satisfy its financial obligations.
  - **Disclosure Rules**—A licenced litigation funder would be required to disclose certain information to consumers and the market. This would ensure that potential claimants are not misled as to who is promoting the funding arrangement, and that any potential conflicts of interest are disclosed.
  - **Breach Reporting**—A licenced litigation funder would be subject to the existing breach reporting requirements that apply to AFSL holders.
  - **Minimum Content of TPLF Agreements**—A licenced litigation funder which enters into a funding arrangement would be obliged to ensure that the arrangement is covered by an agreement in writing that addresses certain specified matters.
  - **Compliance Obligations**—A licenced litigation funder would be required to implement policies and procedures that ensure licensees comply with the licence conditions. This would include an obligation on licenced litigation funders to train their employees in compliance practices and procedures.
  - **Best Interest Obligation**—A licenced litigation funder which enters into a funding arrangement would be under
a non-derogable duty to act in the best interest of its clients, and to place the best interests of its clients ahead of their own; and in circumstances where a conflict arises, prioritise the interests of their clients over their own.

- **Obligation in Relation to Conflicts of Interest**—A licenced litigation funder which enters into a funding arrangement would have a number of duties in relation to conflicts of interest that might arise in the course of that arrangement. These would include a general duty to maintain adequate practices for managing any conflict of interest (as presently applies to funder vehicles that hold an AFSL); and a specific duty to avoid conflicts of interest with the claimant in certain specified circumstances.

- **Appointment of Claimants Representative**—A licenced litigation funder which enters into a funding arrangement would be required to propose a claimant from the class to serve as the claimants’ representative, subject to approval by the court.

Frankly, it's hard to see how any reputable litigation funder could object to these proposals. This is particularly so given that many litigation funders already assert - albeit without any real basis for doing so - that they owe a fiduciary duty to their clients.

That said, implementing this proposal will require a good deal of work on the part of its proponents. However, there is already a good deal of support for reform in this area. The Federal Attorney-General has indicated that he shares many of the concerns that have been raised in relation to litigation funders and his ready to consider proposals to address those concerns. Similarly, an interim report into Access to Justice prepared by the Federal Government’s Productivity Commission has recommended reform in this area and its final report is awaited with interest. Significantly, the Productivity Commission cannot be characterized as simply another a pro-business organization - its draft report also recommended the introduction of US style contingency fee agreements!

Clearly, the coming months in Australia will be interesting!

**The full report recommending a licensing regime can be viewed here:**

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