

U.S. Chamber Institute for Legal Reform

**Submission to the
Australian Law Reform Commission**

**Inquiry into Class Action Proceedings
and Third-Party Litigation Funders**

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1. **The U.S. Chamber Institute for Legal Reform**

The U.S. Chamber of Commerce Institute for Legal Reform (**ILR**) is pleased to make this submission in response to the Australian Law Reform Commission's (**Commission**) call for submissions in relation to the reference it received from the Attorney-General on 11 December 2017 (**Reference**). ILR welcomes the Commission's investigation into the issues of litigation funders and class actions, which are ripe for reform.

ILR is a not-for-profit public advocacy organisation affiliated with the U.S. Chamber of Commerce, which is the world's largest business federation representing the interests of more than three million businesses of all sizes and sectors, as well as state and local chambers, and industry associations. ILR's mission is to ensure a simple, efficient and fair legal system. Since ILR's founding in 1998, it has worked diligently to limit the incidence of litigation abuse in the U.S. courts and has been actively involved in legal reform efforts in the U.S. and abroad. Its members have a direct interest in how litigation is conducted in Australia as many carry on business in Australia or trade with Australians.

The total trade in goods between the United States and Australia in 2017 was approximately AUD \$43.6 billion.¹ Australia's total investment in the United States in 2016 amounted to around AUD \$664.5 billion and the United States investment in Australia was approximately AUD \$896.9 billion.² The United States is Australia's third largest trading partner.³

United States foreign direct investment (**FDI**) into Australia accounts for approximately 22.4 percent of Australia's total FDI.⁴ In 2017, the total FDI into Australia from the U.S. was approximately AUD\$190 billion.⁵ As a net capital importer, Australia is dependent on investment from U.S. businesses.

Given this level of trade and investment, U.S. businesses have a direct interest in the Australian legal system. They and their subsidiary companies also have direct exposure to litigation in Australia, and, in particular, to class actions.

2. **Conclusions And Responses To The Commission's Proposals And Questions**

Summary of Major Conclusions

The protections currently provided to consumers of litigation funding services are inadequate.

Specifically:

- (a) the level of disclosure provided by litigation funders is generally inadequate and often results in funders failing to disclose critical information. A regime to ensure the provision of adequate disclosure of relevant information should be imposed on all litigation funders;

¹ Department of Foreign Affairs and Trade, *United States Fact Sheet*, June 2018 <<http://dfat.gov.au/trade/resources/Documents/usa.pdf>>.

² Department of Foreign Affairs and Trade, *United States Fact Sheet*, June 2018 <<http://dfat.gov.au/trade/resources/Documents/usa.pdf>>.

³ Foreign Investment Review Board, *Annual Report 2016-17* Foreign Investment Review Board (May 2018), 18.

⁴ Foreign Investment Review Board, *Annual Report 2016-17* Foreign Investment Review Board (May 2018), 18.

⁵ Department of Foreign Affairs and Trade, *United States Fact Sheet*, June 2018 <<http://dfat.gov.au/trade/resources/Documents/usa.pdf>>.

- (b) conflicts of interest are a serious issue in relation to litigation funding. The limited requirement that litigation funders put in place systems to 'manage' conflicts of interest is inadequate;
- (c) the remuneration charged by some litigation funders in terms of success fees and other charges is excessive;
- (d) the absence of any prudential oversight or capital adequacy requirements creates a substantial counterparty risk. Litigation funders should be subject to a similar degree of prudential supervision as other financial services providers are, including with respect to capital adequacy provisions; and
- (e) there is little clarity as to the degree of control which may appropriately be exercised by litigation funders, as opposed to named plaintiffs, in the conduct of funded proceedings.

The Australian litigation funding industry operates in a national market funding class actions, traditional (single party) litigation and arbitral proceedings. Litigation funders should be regulated by way of a licencing regime and subject to supervision at the national level. The obligations and controls imposed on litigation funders should apply to all funded proceedings, including class actions, traditional litigation and arbitral proceedings.

While some argue that the removal of the prohibition on solicitors entering into contingency fee agreements may lead to some increased competition in the litigation funding market, there is no empirical evidence of which ILR is aware to support that proposition. In any event, it is unlikely to have any significant impact on the other issues that have been identified by both the Commission and other commentators. However, other significant adverse consequences would flow from contingency fee agreements such that the prohibition on contingency fees should remain.

A summary of ILR's positions on specific Commission Proposals and Questions follows. An explanation of ILR's views can be found in the later sections of this submission.

Response to the Commission's Proposals and Questions in Relation to Continuous Disclosure

Proposal 1-1 (Review of continuous disclosure obligations)

ILR shares the concerns of the Australian business community, shareholders, directors, the insurance industry and others in relation to the adverse impacts of class action litigation generated by the continuous disclosure obligations as they presently operate.

ILR supports Proposal 1-1 as suggested by the Commission.

Response to the Commission's Proposals and Questions in Relation to the Regulation of Litigation Funders

Comprehensive national reform is required

The Australian litigation funding industry has created a national market which has given rise to a range of issues that require a national solution.

The Commission should advocate for a national solution to a national problem. This solution must address all aspects of the litigation funding industry. Specifically, the solution must apply to all entities which provide third party funding for dispute resolution proceedings, including class actions, single plaintiff litigation and arbitrations. It must also be sufficiently flexible to encompass the emerging new modes of litigation financing, for example portfolio financing.

This is the appropriate time to pursue such a proposal. The Federal Government is engaged in a detailed review of the regulatory models used to regulate the financial services sector.

There is intense public interest in ensuring that consumers who utilise financial services are properly protected and that the conduct of the providers who participate in that market is appropriate and fair. Regulation of the litigation funding industry has also recently been recommended by both the Productivity Commission and the Victorian Law Reform Commission.⁶

In 2014, ILR developed and published a comprehensive proposal for the national regulation of litigation funders.⁷ That proposal addressed a number of the concerns identified in this submission. The ILR's 2014 proposal is summarised in Appendix A.

Proposals 3-1 and 3-2 (Introduction of a licencing regime)

ILR generally supports Proposals 3-1 and 3-2 as suggested by the Commission.

However, ILR is also strongly of the view that any license should also:

- (a) expressly impose a non-derogable duty on litigation funders to:
 - (i) act in the best interest of their clients, and to place the best interests of their clients ahead of their own; and
 - (ii) in circumstances where a conflict arises, prioritise the interests of their clients over their own.
- (b) include a breach reporting requirement along the lines that apply to AFSL holders under the Corporations Act and ASIC Regulatory Guide 78. Specifically, a licenced litigation funder should be required to:
 - (i) notify the regulator in writing within 10 business days of any significant breach (or likely breach) of its obligations as a licence holder. This notification obligation should apply to all licence conditions, disclosure obligations and capital adequacy requirements; and
 - (ii) maintain appropriate breach registers and compliance reporting.
- (c) require proper disclosure to clients and potential clients of the terms of the funding agreement;
- (d) address foreign litigation funders, some of whom have little or no presence in Australia. The participation of foreign funders in the Australian market raises questions about the ability of a client to enforce the terms of any funding agreement or take action in the event of a breach of licence conditions. Therefore, foreign litigation funders operating in Australia must, as a licence condition, expressly:
 - (i) agree that Australian law governs the funding contract; and
 - (ii) irrevocably submit to the jurisdiction of the relevant Australian court.

In choosing an oversight agency it will be critical to ensure that the regulator is:

- (a) proactive in terms of its oversight and enforcement function;
- (b) adequately resourced; and

⁶ Productivity Commission, *Access to Justice Arrangements*, Inquiry Report No 72(2014) vol 2, 601–637; Recommendations 18.1–18.3 and Victorian Law Reform Commission *Access to Justice - Litigation Funding and Group Proceedings*, March 2018 Recommendation 2.

⁷ US Chamber Institute for Legal Reform, *An Oversight Regime for Litigation Funding in Australia*, August 2014 <<http://www.instituteforlegalreform.com/uploads/sites/1/LitinAUS.pdf>>.

- (c) has appropriately qualified and experienced staff who can provide that oversight.

Subject to its ability to satisfy these requirements, ILR would not oppose ASIC as the regulator.

Question 3-1 (Qualifications for licencees)

ILR believes a litigation funding licence should require:

- (a) those who are involved in the management and control of the entity to meet a character test based on the 'fit and proper' criteria imposed on those applying to join the legal profession;
- (b) a financial knowledge and skills requirement of the type required of an AFS licencee running a registered scheme; and
- (c) a responsible manager who is legally qualified and holds a current practicing certificate.

Question 3-2 (Minimum financial resources)

ILR agrees that security for costs orders do not negate the need for capital adequacy. Security for costs orders do not address the risk of the funder being unable to fully fund the costs of running an extensive, complex trial. The consequences for both plaintiffs/class members and defendants of a trial aborting due to a loss of funding mid-trial can be substantial.

ILR believes that licenced litigation funders should be subject to prudential supervision to ensure that the funding vehicle has sufficient capital in Australia to satisfy its financial obligations.

It is proposed that the applicable prudential requirements should include those that already exist under the AFSL regime in addition to the following further obligations:

- (a) satisfy the '*Base Level Financial Requirements*' set out in ASIC Regulatory Guide 166;
- (b) comply with the minimum financial requirements that apply to specific classes of AFSL holders. For example, a litigation funder could be subject to adjusted surplus liquid fund and liquid fund requirements in circumstances where the arrangement under which it conducts business means it is obliged as principal to claimants for an amount in excess of \$1,000,000, or where the litigation funder otherwise holds property on trust for the claimants in the sum of \$100,000 or more;
- (c) satisfy ASIC that it has sufficient assets to cover the potential liabilities associated with an unsuccessful case; and
- (d) maintain liquid capital reserves equal to at least twice the amount of its investments in litigation.

ASIC should conduct an annual audit of the funder to ensure its financial soundness. This would ensure that a litigation funder is capable of paying legal fees, disbursements and any adverse costs order.

Question 3-3 (Should a litigation funder be required to join the Australian Financial Complaints Authority scheme?)

Having regard to recent developments in other areas of the financial services industry, ILR believes litigation funders should be required to join AFCA as a condition of any licence.

Response To The Commission's Proposals And Questions In Relation To Conflicts Of Interest

Proposal 4-1 (Reporting on compliance with RG248)

As ILR observes in this submission and the Commission states in the Discussion Paper, the effectiveness of RG248 in its current form is of limited value and effectiveness.

While imposing an obligation to report annually to the regulator in relation to a funder's compliance may be an improvement on the current situation, RG248 will continue to be of limited value until compliance with its terms is enforced by a proactive regulator.

In particular, its effectiveness will be limited until such time as it is enforced in terms that ensure proper and effective disclosure of conflicts and their management to clients.

Proposal 4-2 (Definition of litigation funding)

The litigation funding industry continues to evolve in both its scope and structure. Accordingly, it is imperative that any regulatory regime or other solution is sufficiently flexible to accommodate future developments and new modes of funding.

In these circumstances, ILR supports this proposal as ensuring the existing level of regulation, such as it is, is extended to new modes of funding is preferable to leaving them completely unregulated.

Proposal 4-3 (Accreditation of solicitors)

ILR supports the concept of accreditation for solicitors in class action law and practice.

Lawyers acting for defendants in class actions have observed that there is a wide variation in the experience and expertise of those acting for plaintiffs. In some instances, it has been clear that the lawyers involved did not understand what was involved when acting in a matter where there was a large class of otherwise unrepresented class members. This, coupled with a misunderstanding of some aspects of class action practice and procedure, has resulted in the parties incurring significant unnecessary costs, lengthy delays and the use of court time that could have otherwise been better employed.

Proposal 4-4 (Prohibiting interest in funders in certain circumstances)

ILR supports the amendment of the Australian Solicitors' Conduct Rules as proposed.

ILR also believes that, while the circumstances have not arisen in the past, the Commission should consider the application of a similar rule to barristers.

Proposal 4-5 (Disclosure in matters other than class actions)

ILR strongly supports the amendment of the Australian Solicitors' Conduct Rules as proposed.

Proposal 4-6 (Amendment to GPN-CA in relation to conflicts)

ILR strongly supports the concept recommended in Proposal 4-6 but notes that this would only apply to class actions in the Federal Court of Australia (**Federal Court**).

ILR believes the same principal and obligation should apply to all funded proceedings coming before a federal court or indeed in any other court or arbitral proceeding. This could be achieved by way of an amendment to the Australian Solicitor's Conduct Rules (**ASCR**).

If the Commission is not minded to recommend such an amendment to the ASCR, the Commission should recommend the Attorney-General propose to the Council of Attorneys-General that similar requirements be introduced in all states and territories.

Response To The Commission's Proposals And Questions In Relation To Contingency Fees And Commission Rates

Proposals 5-1 and 5-2 (Contingency fees)

ILR strongly opposes Proposals 5-1 and 5-2 recommending the removal of the prohibition on solicitors entering into contingency fee agreements with their clients.

In the event that the Commission adopts these proposals or a variation that involves removing the prohibition on solicitors entering into contingency fee agreements with their clients, ILR believes the limitations that have been proposed are essential.

Question 5-1 (Carve out of some matters from a contingency fee regime)

As previously stated, ILR strongly opposes the removal of the prohibition on solicitors entering into contingency fee agreements with their clients in any circumstances.

ILR believes it would be difficult, if not impossible, to effectively carve out some matter types from a contingency fee regime, given the blending of claims and remedies that occur in many matters.

Proposal 5-3 (Power to vary or set commission rates)

ILR supports Proposal 5-3 and, if the prohibition on solicitors entering into contingency fee agreements with their clients is removed in whole or in part, believes it should be applied equally to contingency fees.

ILR is concerned that there may be doubt as to the Court's power to make such an order as the legislation currently stands and believes that any doubt should be removed.

ILR believes that the ability of a court to make such an order should not be restricted to class actions in the Federal Court. Rather, the same power should be available to all courts in relation to all funded proceedings coming before a federal court or, indeed, any other court or arbitral proceeding.

Accordingly, ILR recommends that the Commission:

- (a) amend the proposal such that the same power should be available to all courts in relation to all funded proceedings coming before a federal court; and
- (b) recommend the Attorney-General propose to the Council Of Attorneys-General that similar powers be introduced in all states and territories.

Question 5-2 (Limits on commission rates)

ILR does not support the introduction of a blanket statutory cap on contingency fees or a litigation funder's total remuneration (not just 'commission').

Rather, ILR believes a more flexible approach is required which would involve:

- (a) in the case of a pre-verdict settlement, the stage the proceedings have reached;
- (b) the amount the litigation funder has invested in the proceedings – to be reflected in the litigation funder's return on its investment (**ROI**);
- (c) the total amount awarded to the plaintiff by way of verdict or settlement before the deduction of legal costs and the litigation funder's remuneration;

- (d) an assessment of the risk taken by the litigation funder in funding the proceedings, including consideration of any steps taken by the funder to off-set its risk, for example, obtaining after the event insurance, and the way that this was funded; and
- (e) a mechanism for limiting the percentage of damages that can be taken by the funder in personal injury matters, particularly those involving catastrophic injuries.

Given the emergence of the common fund order, even fewer cases will involve even a pretence of the class members being able to negotiate terms with the funder before the case is commenced. Accordingly, regulation is essential if consumers are to be adequately protected.

Question 5-3 (Imposition of statutory cap)

ILR believes the same approach should be taken to contingency fee agreements if the prohibition on solicitors entering into contingency fee agreements with their clients is removed.

Question 5-4 (Class action reinvestment fund)

ILR does not support the introduction of a class action reinvestment fund or similar entity.

First, if a claim is in fact truly 'meritorious' it will be funded by a funder or on a 'no win, no pay' basis.

Second, absent a significant injection of government (tax payer) funding, it is unlikely that any fund relying on a tax or levy of one percent of fees recovered from contingency or litigation funding agreements will build a sufficient capital base in the short to medium term capable of providing meaningful support.⁸

Third, it would, in truth, be a tax or levy on successful claimants who have already given up a very significant proportion of their damages to the funder or lawyer acting on a contingency fee agreement. The creation of a fund thwarts the concept that damages are intended to compensate the plaintiffs in that case.

Response To The Commission's Proposals And Questions In Relation To Competing Class Actions

Proposal 6-1 (Amendments to the *Federal Court of Australia Act 1976 (Cth)*)

ILR believes that any proposal to deal with the issue of competing class actions must address the problems of competing class actions in more than one jurisdiction in Australia and not just the Federal Court.

Proposal 6-2 (Amendments to GPN-CA)

ILR believes that any proposal to deal with the issue of competing class actions must effectively address the problems across all competing class actions that have been commenced in more than one jurisdiction in Australia and not just in the Federal Court.

Question 6-1 (Exclusive jurisdiction for Federal Court in corporations matters)

ILR does not support the proposal that the Federal Court should be given exclusive jurisdiction with respect to civil matters, commenced as representative proceedings, arising under the *Corporations Act 2001 (Cth)* and/or the *Australian Securities and Investments Commission Act 2001 (Cth)* if this is only being proposed in an effort to address the issue of competing class actions.

⁸ The Ontario Class Proceedings Fund charges a fee capped at 10% of the settlement amount. While Law Aid is entitled to charge a fee of 10% the common charge is said to be 5.5% - See Victorian Law Reform Commission *Access to Justice - Litigation Funding and Group Proceedings*, March 2018 (**VLRC Report**) paras 5.130 and 5.134

ILR believes that the Victorian Law Reform Commission's (**VLRC**) recommendation, that the Council of Attorneys-General work to establish a cross-vesting judicial panel for class actions, is sound. The judicial panel would then make decisions regarding the cross-vesting of class actions, where multiple class actions relating to the same subject matter or cause of action are filed in different jurisdictions.⁹

Response To The Commission's Proposals And Questions In Relation To Settlement Approval And Distribution

Proposal 7-1 (Oversight of legal costs)

ILR supports the proposal that a referee be appointed to assess legal costs and the work undertaken by solicitors as proposed.

ILR believes that such an assessment should include all costs and disbursements including fees charged by experts and counsel.

Question 7-1 (Administration of settlement distribution)

ILR believes that settlement distribution should be subject to a tender process.

Tenders should be called in a form agreed by the parties once the terms of the settlement have been resolved.

The outcome should be decided by the Court after an assessment of the tenders by a Registrar of the Court.

Question 7-2 (Confidentiality of settlements)

ILR believes that, as a general rule, it is in the public interest that the confidentiality of settlements should be respected.

The Court's decision in a settlement approval hearing should include sufficient information to allow the reader to ascertain:

- (a) the fees and charges paid to the litigation funder; and
- (b) the percentage of the compensation or damages received by the class that has been deducted to pay:
 - (i) the litigation funder's commission, fees and charges however described; and
 - (ii) legal costs and disbursements.

Response To The Commission's Proposals And Questions Relating To A Possible Regulatory Redress Scheme

Proposal 8-1 (Federal collective redress scheme)

ILR does not support a recommendation that the Australian Government consider establishing a regulatory redress scheme in the absence of a proper inquiry to consider such a scheme.

If the benefits of a regulatory redress scheme are to be considered, this should occur in the context of an appropriate review rather than as an addendum to the current Reference.

⁹ VLRC Report paras 4.89 - 4.98 and Recommendation 12.

Question 8-1 (Design of possible Federal collective redress scheme)

ILR does not believe that sufficient consideration or analysis has been undertaken for a proper response to this question at this time.

3. Introduction

3.1 The litigation funding industry

The evolution of litigation funding in Australia and the basic contractual arrangements between litigation funders and their clients have been well documented in the Commission's Discussion Paper, the earlier Consultation Paper released by the Victorian Law Reform Commission in 2017 entitled '*Access to Justice - Litigation Funding and Group Proceedings*' (**VLRC Consultation Paper**),¹⁰ and elsewhere.

Accordingly, this submission will restrict its comments in relation to the evolution of the litigation funding industry to more recent developments.

Litigation funding: a global investment business

In January 2017, Stuart Clark of Clayton Utz surveyed the litigation funding market in Australia. The survey findings demonstrated how far the funding industry has grown since the decision of the High Court of Australia in *Fostif* in 2009.¹¹

Specifically:

- The survey identified 54 litigation funding entities that were then, or had been, operating in the Australian litigation market.¹² At the time of the survey, some 31 of the entities appeared to be active through either funding ongoing proceedings or promoting their services to the market.
- The majority of the litigation funding entities were incorporated in Australia, while ten were established offshore in Europe, the United States, or Asia. Some litigation funders that operate as local propriety companies are in fact subsidiaries of foreign corporations, thus highlighting the importance of capital adequacy requirements.
- The structure of the funding entities identified in the survey varied. Some of the incorporated entities were publicly listed on the Australian Stock Exchange (**ASX**),¹³ although the majority were incorporated as proprietary companies. At least one of the funding entities was established as a charity with a stated objective of funding what it describes as 'not for profit' claims.¹⁴ This entity is linked to the 'progressive' political campaigning organisation GetUp!.¹⁵

¹⁰ Victorian Law Reform Commission, *Access to Justice - Litigation Funding and Group Proceedings*, Consultation Paper, (July 2017).

¹¹ (2006) 229 CLR 386.

¹² Unpublished data held by, S Stuart Clark AM.

¹³ For example, IMF Bentham Limited, JustKapital Limited and Litigation Lending Services Limited.

¹⁴ Grata Fund Limited.

¹⁵ See, Paul Oosting, *About us* (2017) GetUp! <<https://www.getup.org.au/about>>.

- A number of the funding entities identified were controlled by, or had links to, Australian plaintiffs' law firms including Slater & Gordon,¹⁶ Maurice Blackburn,¹⁷ and Mark Elliott's interests.¹⁸

Since the completion of the survey, a number of new litigation funders have entered the Australian market, including one significant entity from the United Kingdom, Augusta Ventures Limited.¹⁹

By far the largest litigation funding entity in Australia is IMF Bentham - the first publicly listed funder in Australia. In the 2016-2017 financial year, IMF Bentham recorded a \$25.7 million profit before tax and a \$113 million gross income from litigation funding.²⁰ IMF Bentham continues to increase the number of cases funded each year, with 32 cases being funded in 2017 amounting to a total capital commitment of \$78 million.²¹

One of Australia's more recently established litigation funders, Investor Claim Partner Pty Ltd, launched by John Walker, co-founder of IMF Bentham, has noted:

*"Claims funding has developed rapidly in recent years as an alternative asset class. Funds sourced in this capital raising are an important next step in building scale in our claims portfolio."*²²

Litigation is now viewed as an alternative asset class for investors, with returns uncorrelated to traditional investments.²³ Yet, unlike traditional investments, unless a funder is a publicly listed company, it is subject to minimal regulation.

¹⁶ Slater & Gordon created Complete Litigation Funding Solutions which offers a variety of funding options for clients, though the strong links Slater & Gordon have to litigation funders including Therium Australia Ltd. See, Slater & Gordon Lawyers, *Complete Litigation Funding Solutions*, (2017) <<https://www.slatergordon.com.au/dispute-resolution/litigation-funding>>; Slater & Gordon Lawyers, *Spotless class action: Slater and Gordon partners with Therium Australia to improve access to justice with market leading funding model* (2 February 2017) <<https://www.slatergordon.com.au/media-centre/media-releases/spotless-class-action-slater-and-gordon-partners-therium-australia>>.

¹⁷ Maurice Blackburn, created its own funder, the Claims Funding Australia Trust, which has as its trustee, Claims Funding Australia. Two of Maurice Blackburn's senior principals are shareholders in the funder, while a third serves as one of the funder's three directors. They share a registered office. In addition, all of Maurice Blackburn's principals are beneficiaries of the discretionary trust. See, John Emmerig and Michael Legg, 'Litigation funding in Australia a tangled web' (1 August 2013) *Company Director* 3.

¹⁸ Melbourne City Investments (**MCI**), a company which acquired small parcels of shares in a number of companies. In late 2013, MCI launched securities class actions in the Victorian Supreme Court against those companies, alleging that it, and other class members, had lost share value as a result of misleading and deceptive conduct. MCI's sole director and shareholder is Mark Elliott, a Victorian solicitor, who was acting for the class in the proceedings on a "no win, no fee" basis. See, Andrew Morrison, *Riding the outer boundaries of litigation funding*, Clayton Utz (19 February 2015) <<https://www.claytonutz.com/knowledge/2015/february/riding-the-outer-boundaries-of-litigation-funding>>.

¹⁹ Augusta Ventures Limited, *About us* (2017) <<https://www.augustaventures.com/origination/>>.

²⁰ IMF Bentham, *Annual Report 2017* (25 August 2017) 1 <<http://www.imf.com.au/shareholders/annual-reports>>

²¹ *Ibid*, 3.

²² Sol Dolor, *Australia's newest litigation funder raises \$2m to fund cases* (24 March 2017) *Australasian Lawyer* <<https://www.australasianlawyer.com.au/news/australias-newest-litigation-funder-raises-20m-to-fund-cases-234463.aspx?m=1>>.

²³ See for example, Michael McDonald, 'Litigation Finance is one of the few cheap asset classes', *Litigation Finance Journal* (online) 30 May 2017 <https://litigationfinancejournal.com/litigation-finance-one-cheap-asset-classes/>; Max Volsky, *Litigation Finance: An Attractive New Asset Class for Accredited Investors* (12 August 2016) *Wealth Forge*, <<https://www.wealthforge.com/insights/litigation-finance-an-attractive-new-asset-class-for-accredited-investors>>; Australian Dividend Investor, *What is Litigation Funding?* (6 May 2017) <<http://www.australiandividendinvestor.com/2017/05/06/what-is-litigation-funding/>>; LawFunder.org, *Litigation funding*

The importance of the industry is reflected in its expanding role in the litigation system. A recent study noted that over the five year period from 1 June 2012 to 31 May 2017, litigation funders financed 46.2 percent of all class actions nationally.²⁴

While much of the debate around litigation funding is focused on its role in funding class actions, it is important to understand that this is only one aspect of the industry. Litigation funding is also provided to individual plaintiffs to prosecute individual claims in both the courts and in arbitration proceedings. Accordingly, any consideration of the issues raised in this Reference must be considered in the context of class actions, traditional litigation and arbitration.

Moreover, any reforms must take into account the fact that the current business models and products offered by litigation funders are not static. Elsewhere in the world, funders are beginning to finance the entire litigation portfolios of law firms.²⁵ Litigation funders in the United States have also begun acquiring capital through the use of crowdfunding, and funding arrangements that increasingly complex and sophisticated.²⁶ New business models will raise different issues or variances of existing issues, for example conflicts of interest.

Funders are moving to off-load risk

As the litigation funding industry has developed in Australia and elsewhere, the terms of the funding agreements have evolved.

For example, funders have adopted After the Event Insurance (**ATEI**) to manage the risk of an adverse costs order in the event the funded proceedings are unsuccessful. It represents both a comparatively recent development in the evolution of litigation funding and a good example of some of the disclosure, remuneration, and other issues associated with the litigation funding industry.

A key aspect of Australian litigation funding agreements is an undertaking, given by the funder, to indemnify the funded client against any adverse costs order in the event that the proceedings are unsuccessful. The litigation funding industry has long argued that the success fees and other remuneration taken by the litigation funder in part reflect the risk of having to pay these costs if proceedings are unsuccessful.²⁷ However, some litigation funders are now taking out ATEI policies to protect themselves against the risk of having to honour this indemnity. As a general rule, it appears the premium for an ATEI policy is in the order of 20-40 percent of the total legal charges protected against, although it can be lower.²⁸ However, the

an attractive emerging asset class (13 October 2015) <<https://www.lawfunder.org/investment/litigation-funding-an-attractive-emerging-asset-class/>>.

²⁴ Vince Morabito, *An Empirical Study of Australia's Class Action Regimes, Fifth Report: The First Twenty-Five Years of Class Actions in Australia* (July 2017).

²⁵ Woodsford Litigation Funding, *Law Firm Portfolio Finance*, (2017) <<http://woodsfordlitigationfunding.com/law-firm-finance/law-firm-portfolio-finance/>>; Burford, *Portfolio & complex financing*, (2017) <<http://www.burfordcapital.com/customers/portfolio-financing/>>; JustKapital, an Australian based litigation funder, provides disbursement funding for law firms: see JustKapital, *Disbursement Funding*, (2017) <<https://www.justkapital.com.au/about/disbursementfunding/>>.

²⁶ Steve O'Hear, *CrowdJustice, the crowdfunding platform for public interest litigation, raises \$2M and heads to U.S.*, TechCrunch (30 May 2017) <<https://techcrunch.com/2017/05/30/crowdjustice-the-crowdfunding-platform-for-public-interest-litigation-raises-2m-and-heads-to-u-s/>>.

²⁷ IMF Bentham, *Benefits of Funding with IMF Bentham* (2017) <<http://www.imf.com.au/funding/>>; LCM, *Fees* (2017) <<https://www.lcmfinance.com/working-with-lcm/fees/>>; Stephen Dilley, Gareth Kagan and Davina Watson, *Risk transfer in commercial litigation: risk, finance, funding and insurance solutions* Bond Dickinson LLP (31 March 2016) <<https://www.bonddickinson.com/insights/publications-and-briefings/risk-transfer-commercial-litigation-risk-finance-funding-and/>>; Standing Committee of Attorneys-General, Parliament of Australia, *Litigation Funding in Australia Discussion Paper* (May 2006) 4.

²⁸ Standing Committee of Attorneys-General, Parliament of Australia, *Litigation Funding in Australia Discussion Paper* (May 2006) 15; Augusta Ventures Limited, *Frequently Asked Questions* (undated) Augusta Ventures Limited <

premiums are often passed on to the funded client and, if the case is successful, the cost of the premium is deducted from the amount received by way of judgement or settlement.²⁹

ILR is also aware that some funders are not in fact offering an indemnity against an adverse costs order. Rather, they are requiring the funded client to purchase an ATEI policy as a condition of receiving funding from the lender.³⁰ It appears that there may also be a link or, at the very least, some commercial arrangement or understanding between the litigation funder and the insurer.

This development represents a significant change in the way in which litigation funders operate. It transfers a significant component of the risk associated with an adverse outcome in the proceedings, away from the litigation funder. This, in turn, raises important questions in relation to the justification for the levels of remuneration received by funders.

It also gives rise to further concerns in relation to disclosure by the litigation funder to clients and prospective clients in terms of the policy wording, the relationship between the funder and insurer and the ability of the insurer to meet its obligations under the policy.

Given the courts approach to similar questions, it is unlikely that they will be willing to address these issues. ILR is only aware of two instances where the use of a deed of indemnity by a foreign insurer as security for costs has been approved.³¹ In neither case did the Court,

*...inquire into the reasons why, or the terms on which, a bank agrees to provide a plaintiff with a bank guarantee addressed to the defendants by way of security for costs...[as] the private arrangements...are no business of the defendants or the Court.*³²

Rather, the Court assessed whether the proposed security satisfied the protective object of a security for costs order, namely, to provide a fund or asset against which a successful defendant could readily enforce an order for costs against the plaintiff.³³

Consequently, the questions surrounding the details and limits of the insurance policy were not assessed. The Court did not inquire as to any disclosures the litigation funder had made to the insurer in order to obtain the policy. Similarly, the Court gave little consideration as to whether the insurer was financially sound and able to meet its obligations.

<https://www.augustaventures.com/faqs/>; Universal Legal Protection, *After The Event Insurance*, Universal Legal Protection (2017) <http://ulpltd.co.uk/page/660/after_the_event_insurance>.

²⁹ Universal Legal Protection, *How much does After the Event (ATE) Insurance Cost?* Universal Legal Protect (2017) < http://ulpltd.co.uk/page/660/after_the_event_insurance>; *Motto v Trafigura Ltd* [2011] EWCA Civ 1150 (a contingent deferred premium set at 62% was recovered in full); *Clarke v Sandhurst Trustees Limited (No.2)* [2018] FCA 511.

³⁰ Augusta Ventures Limited, *Frequently Asked Questions* (undated) Augusta Ventures Limited < <https://www.augustaventures.com/faqs/>>; Jamie Sorrell, *Third-party funders and their exposure to adverse costs liabilities*, Clyde & Co (1 July 2016) < <https://www.clydeco.com/insight/article/third-party-funders-and-their-exposure-to-adverse-costs-liabilities>>.

³¹ In *DIF III Global Co-Investment Fund, L.P. & Anor v BBLP LLC & Ors* [2016] VSC 401, the Court held that the proposed deed of indemnity, and payment into Court or bank guarantee of amount sufficient to cover costs of registration of any judgment against the insurer in the United Kingdom, constituted adequate security in the circumstances. See also, *Australian Property Custodian Holdings Ltd (in liq) (recs and mgrs apptd) (controllers appointed) v Pitcher Partners (firm)* [2015] VSC 513.

³² *DIF III Global Co-Investment Fund, L.P. & Anor v BBLP LLC & Ors* [2016] VSC 401, [72].

³³ *Ibid*; *Australian Property Custodian Holdings Ltd (in liq) (recs and mgrs apptd) (controllers appointed) v Pitcher Partners (firm)* [2015] VSC 513 [56] - [57].

The use of ATEI policies, coupled with the lack of any meaningful disclosure requirements by the litigation funder relying on such a policy, raises a number of questions – most of which will not be answered by the litigation funders, including:

- (a) What are the terms of the specific insurance policy – will it respond to a claim under all circumstances; are the policy limits sufficient to meet any order?
- (b) Is the insurer financially sound and capable of meeting its obligations?
- (c) What information has been provided to the insurer in relation to the risk – has the litigation funder satisfied its obligations of the utmost good faith?

The increase in the use of ATEI also gives rise to further questions in relation to the extent of the risk actually faced by litigation funders and the appropriate level of reward they should receive to compensate them for that risk.³⁴ If the risk of satisfying an adverse costs order has been significantly reduced or extinguished by way of ATEI (albeit on the payment of a premium which has presumably been priced into the funding proposal), that is a matter that should be disclosed. Disclosure provides transparency and ensures that it is taken into account in any assessment by a potential client or the court of the reasonableness of the proposed fees and charges. If that information is not available, there can be no proper assessment.

3.2 Does litigation funding increase access to justice?

The litigation funding industry argues that litigation funding has improved access to justice; however, its impact is generally overstated by the industry.

Litigation funders only fund those cases where they believe there is a high prospect of substantial return on their investment. They have no interest in funding claims that are marginal, prospective, or can be resolved without significant financial return – for example, applications for injunctive relief.³⁵

As IMF Bentham, Australia's largest litigation funder, has observed,

*"[t]hird party litigation funding will not assist in providing access to justice for the vast majority of civil actions currently before the courts."*³⁶

3.3 Has litigation funding increased the workload of the courts?

There can be no doubt that the emergence of litigation funding has resulted in an increase in the number of cases coming before the courts.³⁷ This is simply a consequence of the fact that the availability of funding on a non-recourse basis, coupled with the protection against an adverse costs order, has allowed and/or encouraged plaintiffs who would not previously have commenced proceedings, to do so. This ease of access can increase the incidence of questionable claims, as well.

³⁴ Stephen Dilley, Gareth Kagan and Davina Watson, *Risk transfer in commercial litigation: risk, finance, funding and insurance solutions* Bond Dickinson LLP (31 March 2016) <<https://www.bonddickinson.com/insights/publications-and-briefings/risk-transfer-commercial-litigation-risk-finance-funding-and>>.

³⁵ See, IMF Bentham, *Portfolio Funding* (2017) <<https://www.benthamimf.com/what-we-do/portfolio-funding>>.

³⁶ Simon Dluzniak, *Litigation Funding and Insurance*, IMF Bentham, 15<<https://imf.com.au/docs/default-source/site-documents/paper---dluzniak>>.

³⁷ Forty-three per cent of all instances of competing class actions in Australia occurred after the decision of *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275. See, Vince Morabito, 'Empirical Perspectives on 25 Years of Class Actions' in Damian Grave and Helen Mould (eds), *25 Years of Class Actions in Australia: 1992–2017* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2017) 43, 57.

It is also recognised that a degree of entrepreneurial litigation has emerged. That is, funders and lawyers actively seek out potential causes of action, find a plaintiff or group of plaintiffs, and then promote the case in the media to support a 'book build' before actually commencing proceedings. While the activities of Mark Elliott, which are dealt with at section 6 of this submission, provide a particularly egregious example of this practice, there are many others.

Empirical evidence supports the contention that litigation funding has led to an increase in litigation and court workloads.³⁸ This workload can only increase as:

- (a) the courts take a more aggressive approach to the management of class actions including, for example, determining the level of remuneration to be paid to litigation funders and dealing with competing class actions; and
- (b) the seemingly inevitable increase in the number of class actions in absolute terms coupled with increasing class size and complexity.

4. Regulating Litigation Funders

4.1 The case for proper regulation and supervision of litigation funders

In this section of the submission ILR sets out the case for the regulation of the litigation funding industry.

Most would consider this beyond doubt given the overwhelming support for regulation. The call for regulation is not a recent development. For example, a paper prepared for the Standing Committee of Attorneys-General in May 2006,³⁹ well before the decision in *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd*⁴⁰ which effectively confirmed the legality of the litigation funding industry, identified the risks that are still being discussed today and canvassed the need for regulation. Regrettably, no action was taken in response to that paper.

More recently, two extensive reviews have recommended the regulation of litigation funders.

First, in 2014, the Productivity Commission conducted an inquiry into *Access to Justice Arrangements* which included consideration of the role played by litigation funders in litigation. The Productivity Commission recommended that litigation funders should be required to hold a licence which would ensure that they:

- (a) can satisfy any liabilities they incur;
- (b) properly inform their clients of relevant obligations; and
- (c) implement systems for managing conflicts of interest.⁴¹

Second, earlier this year the VLRC recommended the national regulation and supervision of litigation funders in its report *Access to Justice - Litigation Funding and Group Proceedings*.⁴²

³⁸ David S Abraham and Daniel Chen, 'A Market For Justice: A First Empirical Look At Third Party Litigation Funding' (2013) 15(4) *University of Pennsylvania Journal of Business law* 1075.

³⁹ Standing Committee of Attorneys-General, Parliament of Australia, *Litigation Funding in Australia Discussion Paper* (May 2006).

⁴⁰ (2006) 229 CLR 386.

⁴¹ Productivity Commission, *Access to Justice Arrangements*, Inquiry Report No 72(2014) vol 2, 601–637; Recommendations 18.1–18.3.

⁴² See para 2.32 and Recommendation 2.

A broad cross-section of those involved in the administration of justice and funded litigation have called for national regulation and oversight of litigation funders, including significantly the largest litigation funder operating in Australia - IMF Bentham.⁴³

4.2 **Lack of regulation fosters lack of transparency**

Despite all that has been written about the litigation funding industry, it is still not well understood by the government, academics or the general public in Australia. In part this is because writings have not been particularly well balanced, but principally because the industry remains opaque by choice. The absence of meaningful regulation serves to ensure this opacity.

This is an important issue for two reasons. First, litigation funders now play a significant role in Australia's civil justice system. Their decisions in relation to whether to fund a case can determine whether or not the claim will be litigated. Litigation funders' decisions are often crucial in determining whether a case, once commenced, will continue,⁴⁴ and the terms on which cases are settled.

Second, the litigation funding industry's business model depends on its ability to access and utilise, at no cost to it, a vital public asset – the court system. For that reason alone, the public (and government) have a vital interest in its transparency.

Other than in the case of litigation funders listed on the ASX where there is some level of market disclosure, little or nothing is known about litigation funders, including:

- (a) their source of funds;
- (b) their profitability;
- (c) the way in which they operate, in particular, their control or influence over the litigation;
- (d) the way in which they deal with their clients; or
- (e) their ability to satisfy their liabilities.

More information about the industry and the way it operates is required to ensure adequate transparency and to allow stakeholders to make a proper assessment of litigation funders' claims and what they offer clients. The disclosures currently required of listed companies are not sufficient given the unique nature of the litigation funding industry and its relationship to the courts, and the simple fact that many litigation funders are not listed.

This lack of transparency is exacerbated by the approach taken in many judgements in applications for the approval of settlements in funded matters. In many cases, there is simply not enough information in the judgement in relation to the terms of the litigation funding agreement, the total remuneration (commission, so called 'management' or 'project' fees and the like) to determine the total cost to the funded client or the percentage of the settlement that has been taken up in the funder's remuneration and legal fees.

⁴³ See for example the submission made to the VLRC inquiry by IMF Bentham.

⁴⁴ For example, see Michael Legg, *Regulations needed for litigation funders who can't pay out when cases fail*, The Conversation (15 February 2017) <<http://theconversation.com/regulations-needed-for-litigation-funders-who-cant-pay-out-when-cases-fail-72502>>; Marianna Papadakis, 'Maurice Blackburn \$11 million out of pocket after failed equine flu class action', *Australian Financial Review* (online), 16 June 2016 <<http://www.afr.com/news/maurice-blackburn-11-million-out-of-pocket-after-failed-equine-flu-class-action-20160615-gpjpev>>. See also *Clasul Pty Ltd v Commonwealth of Australia* [2016] FCA 1119 and *Blairgowrie Trading Ltd v Allco Finance Group Ltd*

Until such time as litigation funders are required to be more transparent, it will continue to be very difficult for consumers to properly assess what they are offered in a funding arrangement, let alone effectively compare alternatives or negotiate a fair agreement.

4.3 Litigation funders are essentially unregulated

In large part, the lack of transparency flows from the fact that the litigation funding industry is not subject to any meaningful regulatory or prudential supervision. Unlike law firms, banks, insurers, superannuation funds, financiers, and other lenders, there is no mechanism for regulators to obtain information about the operations or viability of litigation funders. There is no scrutiny of their operations nor oversight of the arrangements they make with their clients.

Litigation funders will respond to an assertion that they are essentially unregulated by pointing to the limited requirements imposed by the Australian Securities and Investment Commission (**ASIC**) and the procedural and other obligations imposed in some jurisdictions. However, while these obligations exist, they are of little practical effect.

Corporations Act and Australian Securities and Investment Commission Act

All incorporated litigation funders are regulated by the *Corporations Act 2001* (Cth) (**Corporations Act**) on the same basis as other corporations; there are no superadded regulations which apply to them because they are litigation funders. Those that are listed on the ASX are also contractually bound to comply with the ASX Listing Rules that are enforceable under the Corporations Act.

In October 2009, the Federal Court held that the funding arrangements in a shareholder class action constituted a managed investment scheme that was required to be registered under sections 9 and 601ED of the Corporations Act.⁴⁵ This decision was followed by a decision of the New South Wales Court of Appeal in March 2011, which held that, because litigation funding could be used to manage financial risk, it was a '*financial product*' which, in turn, obliged the litigation funder to hold an Australian Financial Services Licence (**AFSL**) under the Corporations Act.⁴⁶

However, on appeal, the High Court of Australia held that litigation funders were '*credit facilities*' rather than '*financial products*'. As such, litigation funders were not required to hold an AFSL, but rather, could be regulated under the *National Consumer Credit Protection Act 2009* (Cth).⁴⁷

To remove any ambiguity as to the nature and regulation required of litigation funders, the Federal Government moved to exempt litigation funders from all forms of regulation, save for a requirement that funders have adequate processes to manage (as distinct from avoid) conflicts of interest.⁴⁸ This was purportedly done to improve access to justice.⁴⁹ However, as has already been observed in this submission, there is still very little transparency as to what processes litigation funders have in place to manage any conflicts of interest between the funder and litigant (or class of litigants) or lawyers.

⁴⁵ *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* (2009) 180 FCR 11, [82], [103], [104].

⁴⁶ *International Litigation Partners Pte Ltd v Chameleon Mining NL* (2011) 276 ALR 138, [33]–[45], [122]–[128], [189]–[210].

⁴⁷ *International Litigation Partners Pte Ltd v Chameleon Mining NL (rec and mgr apptd)* (2012) 246 CLR 455, [33], [44].

⁴⁸ *Corporations Amendment Regulation 2012 (No. 6) 2012* (Cth); See also, Patrick Windle, 'IBISWorld Industry Report 05446 Litigation Funding in Australia', IBIS World (February 2017).

⁴⁹ Treasury, Parliament of Australia, *Explanatory Commentary: Exclusion of Class Actions/Litigation Funding Schemes from Managed Investment Schemes* (27 July 2011) 1.

Exempt litigation funders are required to manage conflicts of interest in accordance with the obligations found in ASIC Regulatory Guide 248 (**RG248**). The Commission's Discussion Paper *Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (**Discussion Paper**) provides a useful summary of both the obligations imposed by RG248 and, perhaps more importantly, its deficiencies.⁵⁰

While RG248 purports to impose a robust set of obligations they are, in many respects, illusory.

First, as has been noted elsewhere, there is no mechanism to enforce compliance with the requirements of RG248.

Second, there is no requirement imposed on litigation funders to report on a regular basis in relation to their compliance with RG248.

Third, there is no meaningful or effective oversight of litigation funders in terms of their compliance with RG248 by ASIC or any other regulator. As the Discussion Paper notes there does not appear to be any instance of ASIC investigating a breach of its requirements, let alone taking any enforcement action.⁵¹ ILR is similarly unaware of any such action being taken.

In some respects, this is not surprising in the absence of a proactive approach by the regulator. Complaints will always be rare given the paucity of information provided to many funded clients and the fact that few, if any, are actually involved in the conduct of the proceedings. In circumstances where a funded class member or other litigant has effectively handed over control of the proceedings to the funder and the lawyers it instructs, most clients will never become aware of a conflict, let alone the failure of the funder to have appropriate management arrangements in place.

The reality is that, in the absence of an effective, proactive regulator, it really does not matter what rules, guidelines or other obligations are imposed as some regulated entities will simply fail to comply.

As with any other incorporated entity providing a service or product, litigation funders are also subject to the consumer protection provisions in the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**).⁵² The ASIC Act provides protections for consumers against unfair contract terms,⁵³ unconscionable conduct,⁵⁴ and misleading or deceptive conduct,⁵⁵ as well as an implied warranty that any services will be rendered with due care and skill and be fit for the purpose for which they are supplied.⁵⁶

However, while these provisions exist, it is arguable that many would rarely apply to a litigation funding agreement as some or all such contracts may not meet the definition of a "*consumer contract*".⁵⁷ In any event, because there is very little oversight of litigation funders, and

⁵⁰ See pages 68 - 72.

⁵¹ See para 4.36.

⁵² *Australian Securities and Investments Commission Act 2001* (Cth) s 12BAA (definition of 'financial product'), s 12BAB (definition of 'financial service').

⁵³ *Ibid*, ss 12BF–12BM.

⁵⁴ *Ibid*, ss 12CA–12CC.

⁵⁵ *Ibid*, ss 12DA, 12DB, 12DF.

⁵⁶ *Ibid*, s 12ED(1).

⁵⁷ John Walker, 'Policy and Regulatory Issues in Litigation Funding Revisited' (2014) 55 *Canadian Business Law Journal* 85, 95.

currently no requirement for funders to disclose all funding agreements, these protections do not hold much weight. ILR is unaware of any enforcement of these provisions against a litigation funder.

Other statutory provisions

While most Australian jurisdictions require those involved in litigation before the courts to adopt certain behavioural norms, those obligations are generally only imposed on parties to litigation and their lawyers.⁵⁸ However, in Victoria, litigation funders, like lawyers, are subject to the "overarching purpose" of the *Civil Procedure Act 2010* (Vic) (**Civil Procedure Act**), which is "to facilitate the just, efficient, timely and cost-effective resolution of the real issues in dispute."⁵⁹

Supporting the "overarching purpose" of the Civil Procedure Act are ten "overarching obligations" that apply to parties, expert witnesses, lawyers, and litigation funders involved in civil proceedings.⁶⁰ These obligations require all parties involved in proceedings to act honestly and not mislead, take genuine steps to resolve the dispute and cooperate, minimise delay, and disclose the existence of critical documents.⁶¹ In making an order or giving any direction in a civil proceeding, the Court must further the overarching purpose by having regard to the overarching obligations.⁶²

The Court has made it clear that compliance with the overarching obligations is mandatory rather than aspirational.⁶³ Moreover, unlike the parties who must certify that they understand their obligations prior to commencing proceedings,⁶⁴ litigation funders have no similar obligation. It is also unclear as to how a court would become aware of, let alone assess and address, any breach on the part of a litigation funder to comply with the overarching obligations.

ILR is aware of only two instances where the overarching purpose or overarching obligations have been considered in the context of a litigation funder. In 2014, the Supreme Court of Victoria held that a solicitor, acting as the representative plaintiff and the sole shareholder and director of the litigation funder that was funding the proceedings, Melbourne City Investments, was not conducive to giving effect to the overarching purpose of the Civil Procedure Act.⁶⁵ However, this case was initially brought to the Court's attention as a consequence of the conflict of interests with Mr Mark Elliot as the solicitor. The case was ultimately decided, on appeal, on the basis of the Court's inherent powers to stay proceedings for abuse of process,

⁵⁸ *Federal Court of Australia Act 1976* (Cth), s 37M(1); *Civil Procedure Act 2005* (NSW), s 56; *Uniform Civil Procedure Rules 1999* (Qld), r 5; *Court Procedure Act 2004* (ACT) s 5A; *Rules of the Supreme Court 1971* (WA), r 4A; *General Supreme Court Rules* (NT), r 1.09A; In NSW, funders and insurers must not by their conduct cause parties to breach the parties' duty to assist the Court to further the overriding purpose of facilitating the just, quick and cheap resolution of the real issues in the proceedings: see *Civil Procedure Act 2005* (NSW) s 56. The WA Supreme Court has also introduced rules requiring 'interested non-parties', such as litigation funders, to be identified to the Court, and to be subject to duties in relation to the conduct of the case, including a duty to cooperate with the parties and the Court and not engage in misleading or deceptive conduct: see *Supreme Court Amendment Rules 2012* (WA), inserting *Rules of the Supreme Court 1971* (WA) O 9A.

⁵⁹ *Civil Procedure Act 2010* (Vic) s 7(1).

⁶⁰ *Civil Procedure Act 2010* (Vic) s 10(1)(d)(ii).

⁶¹ *Ibid*, ss16 - 26.

⁶² *Ibid*, s 8.

⁶³ *Yara Australia Pty Ltd v Oswal* (2013) 41 VR 302, 308.

⁶⁴ *Civil Procedure Act 2010* (Vic) s 41(1).

⁶⁵ *Melbourne City Investments Pty Ltd v Treasury Wine Estates Ltd (No 3)* [2014] VSC 340 (23 July 2014), [67].

not on breaches of the overarching obligations by the litigation funder under the Civil Procedure Act.⁶⁶

In *Caason Investments Pty Limited v Cao (No 2)*, the Court noted that the common fund condition precedent in the settlement proposal was inconsistent with the overarching purpose in s 37M of the Civil Procedure Act however, it had already been waived by the applicants (in truth, the funder).⁶⁷

4.4 Regulation of the legal profession

In contrast to the lack of regulation of litigation funders, the Australian legal profession is arguably the most highly regulated profession in Australia.

Scope of regulation

Each state and territory has an extensive regulatory regime governing the conduct of lawyers overseen by proactive, effective, regulators.

Consider, for example, the Victorian regime where, the principal legislation regulating the legal profession is the *Legal Profession Uniform Law Application Act 2014 (Vic)* (**Uniform Law Application Act**), which contains, at Schedule 1, the *Legal Profession Uniform Law (Uniform Law)*. It is supplemented by a number of statutory rules including the *Legal Profession Uniform General Rules 2015 (Vic)*, made by the Legal Services Council.

Victorian lawyers are also subject to a range of other rules including, for example, the *Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015 (Vic)* and *Legal Profession Uniform Legal Practice (Solicitors) Rules 2015 (Vic)*.⁶⁸ These regulations and rules set out principles of professional conduct and specific obligations for lawyers in conducting the relationship with their client, in order to protect clients.

The Uniform Law adopted in Victoria harmonizes the regulation of the legal profession in Victoria and New South Wales, which together represent some 70 percent of the Australian legal profession.⁶⁹

Extensive regulation specifies how a lawyer can charge for legal services and the information they must give their clients in order to allow them to make informed choices about costs and legal options. The regulations cover legal costs, cost disclosure, cost agreements, and cost assessments.⁷⁰

In addition to the regulatory regime imposed by statute, the courts have long held lawyers to be officers of the court, such that they owe a paramount and overriding duty to the court. Second to that duty is their duty to their client.

No such duties are imposed on litigation funders. They are not officers of the court, and owe no obligations to the court beyond those owed by the ordinary citizen. They owe no duties to their clients, the funded litigants, beyond their contractual obligations and those that might be

⁶⁶ *Treasury Wine Estates Ltd v Melbourne City Investments Pty Ltd* (2014) 318 ALR 121, [22].

⁶⁷ [2018] FCA 527 at [37] per Murphey J.

⁶⁸ These rules are applicable only to solicitors. There are also separate rules applicable to barristers in Victoria including *Legal Profession Uniform Conduct (Barristers) Rules 2015 (Vic)* and *Legal Profession Uniform Continuing Professional Development (Barristers) 2015 (Vic)*.

⁶⁹ Law Council of Australia, *How many lawyers are there in Australia?* (2017) <<https://www.lawcouncil.asn.au/resources/faqs/how-many-lawyers-are-there-in-australia>>.

⁷⁰ *Legal Profession Uniform Law Application Act 2014 (Vic)* sch 1, s 174; *Legal Profession Uniform General Rules 2015 (Vic)* r 7.

imposed by the law on any other entity engaged in trade or commerce. Save for the limited obligation to manage conflicts of interest, they have no superadded legal obligations by virtue of them being litigation funders.

Oversight by regulators and court

In order to ensure the legal profession conducts itself in accordance with the significant regulation imposed on it, the profession is also subject to close scrutiny by regulators, the courts and professional bodies. Each of these bodies have demonstrated a willingness to both investigate and prosecute any alleged breach of the rules which apply to lawyers.

Extensive consumer protections

The consumers of Australian legal services have available to them a range of mechanisms that protect them against loss in the event that the lawyer is negligent or acts improperly. For example, there is a well-established complaints procedure for consumers in the event their lawyer acts improperly. The most common complaints concern costs and communication.⁷¹

Again, by way of example, in Victoria, a consumer can make a complaint to the Victorian Legal Services Commissioner (**Commissioner**). The Commissioner will investigate the complaint and make a relevant finding, which may include professional disciplinary action for unsatisfactory professional conduct or professional misconduct. The Commissioner publishes the details of Victorian-registered lawyers who have been found guilty of a disciplinary offence or had their practising certificate suspended or cancelled, on the Register of Disciplinary Action.⁷² This provides an additional element of public scrutiny of the legal profession and a layer of protection for clients to assist them to make informed decisions about the lawyers whom they retain.

Consumers of legal services are also protected by fidelity funds which are funded by the legal profession. In Victoria, the fidelity fund is maintained by the Victoria Legal Services Board and provides compensation to consumers who have lost money or property due to the dishonest or fraudulent behaviour of a lawyer, an employee of a law practice or an approved clerk.⁷³ This protects consumers of legal services, ensuring they will receive compensation in relation to dishonest behaviour by lawyers, whether or not they are able to recover any compensation from the individual lawyer in private proceedings.

As a consequence of the broad scope of regulation, oversight by regulators and the Supreme Court, and protections for consumers, the legal profession is well understood by the courts, regulators, and consumers. As a consequence, each are well placed to make judgments as to the services the legal profession offers and the pricing of those services. Consumers are also in a position to identify and address concerns and improper behaviour and there are established complaint mechanisms in place with penalties for those who breach the law or act improperly.

No similar protections are available to the clients of litigation funders.

⁷¹ Victorian Legal Services Board, *Victorian Legal Services Board and Commissioner Annual Report (2016)* 56.

⁷² Victorian Legal Services Board and Commissioner, *Register of Disciplinary Action* (8 August 2017) <http://lsbc.vic.gov.au/?page_id=285>; Each jurisdiction in Australia has a similar register.

⁷³ Victorian Legal Services Board and Commissioner, *The Fidelity Fund* (22 February 2017) <http://lsbc.vic.gov.au/?page_id=266>.

4.5 **The issues and concerns with litigation funding**

The principal issues and concerns to which the Australian litigation funding industry gives rise are:

- (a) the inadequate disclosure to clients, and potential clients, of the terms on which the litigation funder will be remunerated,⁷⁴ and the extent of control which the funder has over the litigation;
- (b) the conflicts of interest which inevitably arise as between litigation funder and client and, in the context of class actions, the litigation funder and other non-funded class members;
- (c) the remuneration received by litigation funders, as a proportion of any final settlement or judgment sum;
- (d) the risk for a defendant, that it secures a costs order in its favour, but is unable to enforce it against the litigation funder because of the funder's capital inadequacies, insurance or location; and
- (e) the cost to the community and defendants as litigation funders run matters for their own benefit which, in truth, have only a marginal benefit to the plaintiffs. These claims impose unnecessary costs on defendants which are ultimately borne by the broader community while at the same time imposing additional, unnecessary burdens on the courts.

4.6 **Disclosure**

Significant issues arise in relation to the need for disclosure by litigation funders. First, disclosure to the litigation funder's clients and potential clients. Second, disclosure to the court. There is also the question of disclosure to other parties in the proceedings.

Disclosure to clients and potential clients

When a plaintiff enters into a litigation funding agreement they are not just agreeing to reimburse the litigation funder for the costs it has advanced to the lawyer to conduct the case. They are also giving up a substantial proportion of any proceeds of the litigation. The plaintiff is usually also often giving up a degree of control over the conduct of the proceedings to the litigation funder.

Litigation funding contracts are complex agreements that are not easily understood by non-lawyers. In these circumstances it is critical that the client understand the terms of the arrangement they are entering into, the costs they will incur, and the ultimate return they may receive from the litigation.

Unless this information is clearly provided to potential clients before they enter into a litigation funding arrangement, they have no ability to assess the suitability of what they are being offered nor make any meaningful comparison between competing litigation funders. It is also critically important that potential clients have the opportunity to obtain independent advice, both legal and financial, about these arrangements before entering into a binding contract. This can only be done if there is proper disclosure.

This is hardly a revolutionary concept. Businesses that provide financial or insurance services, telecommunication or funeral services, to name but a few, are obliged to provide comprehensive pre-contractual disclosures to potential customers and clients.

⁷⁴ Including where instances where one client has secured a more advantageous agreement than other class members - see for example: *Caason Investments Pty Limited v Cao (No 2)* [2018] FCA 527 at [213] and *HFPS Pty Limited (Trustee) v Tamaya Resources Limited (in Liq) (No 3)* [2017] FCA 650 [66].

As has already been observed, the lawyer engaged by a funded client must provide comprehensive disclosure to their client at the outset and then regularly update that disclosure, as the matter progresses. This ensures that the client not only understands the terms of the arrangement they are entering into but are also kept fully aware of the costs they are incurring or are likely to incur.

No similar obligation is imposed on litigation funders.

Disclosure to the Court

The arguments for disclosing both the fact that a case is being funded by a litigation funder, and the terms of such an agreement to the court were well summarised in the VLRC Consultation Paper.⁷⁵ In brief, full disclosure of the existence of the funding agreement and its terms are essential to ensure:

- (a) the integrity of the proceedings and the proper administration of justice;
- (b) the protection of the interests of the parties - both funded clients and those who are not funded (where that occurs); and
- (c) proper case management.

A recent decision in the Federal Court starkly emphasises the need for a comprehensive regime that mandates full disclosure to both the parties and the court. In *Caason Investments Pty Limited v Cao (No 2)*⁷⁶ it emerged during a settlement approval hearing that the litigation funder had entered into a secret 'side deal' with two of its clients pursuant to which they received more favourable terms than other clients of the funder.

This arrangement was apparently never disclosed to the other class members nor to the Court. Rather, it emerged in a confidential affidavit filed in the course of the settlement approval hearing. As a consequence, other class members were unable to negotiate a similar improvement in terms and the Court was unable to properly discharge its role in protecting the interests of all parties.

Federal Court of Australia mandated disclosure

The Federal Court has recognised the importance of proper disclosure of litigation funding agreements to both clients and the Court itself. It has imposed a number of disclosure requirements for both costs agreement between class members and their lawyer, and litigation funding agreements, by way of a Federal Court Class Actions Practice Note (**Practice Note**).⁷⁷

In terms of disclosure to the client, the Practice Note mandates that the litigation funding agreement must:

- (a) be in writing;
- (b) be in clear terms and be provided as soon as practicable; and
- (c) disclose the litigation charges that will be charged.⁷⁸

The obligation to disclose the litigation funding agreement is imposed on the lawyer and not the litigation funder. It is an ongoing obligation such that further disclosure is required if there

⁷⁵ Ibid, [63] - [66].

⁷⁶ [2018] FCA 527

⁷⁷ Federal Court of Australia, *Practice Note --- Class Actions Practice Note (GPN-CA)*, 25 October 2015, [5].

⁷⁸ Ibid, [5.2] - [5.3].

are any material changes to the litigation funding charges. The Practice Note also requires disclosure of the litigation funding agreement on a confidential basis to the Court and the other parties.⁷⁹

However, while the Federal Court's recognition of the importance of disclosure and adoption of this limited obligation to disclose is to be welcomed, it has a number of obvious limitations. First, it only applies in the Federal Court and then only to class actions. It does not apply to class actions in the Victorian or NSW Supreme Courts, to non-class action litigation nor to arbitrations.

Second, as noted above, the obligation is imposed on the lawyer representing the funded class member and not the litigation funder.

Third, the obligation only arises after the proceedings have been commenced – well after the parties have entered into the funding agreements.

Fourth, in terms of sanctions, the Practice Note merely states that:

*"Failure to...[provide the required disclosure]... may be taken into account by the Court in relation to settlement approval ..."*⁸⁰

There is no oversight to ensure that disclosure has been given until the proceedings are essentially at an end. Indeed, it is not even certain that the Court has a power to compel the production of a funding agreement to another party.

A solution

There is broad agreement that litigation funders must make proper disclosure to clients, potential clients and the courts.

If the concerns that have been identified by earlier inquiries and the Federal Court are to be properly addressed, litigation funders must be obliged to provide both pre-contractual and on-going disclosure to:

- (a) potential clients;
- (b) clients; and
- (c) the Court or tribunal hearing the funded proceedings.

In terms of disclosure to clients and potential clients, the disclosure must be in writing using plain English and disclose the key terms of the litigation funding agreement, including:

- (a) how the litigation funder's remuneration (including all fees and charges however described) will be calculated;
- (b) how the lawyer's remuneration (including all fees and charges however described) will be calculated;
- (c) the decisions which the litigation funder will be entitled to take in the matter and the commensurate removal of decision making power from the claimants or funded parties;
- (d) any conflicts or potential conflicts of interest that may arise and the mechanism for dealing with such a conflict;

⁷⁹ Ibid, [6].

⁸⁰ Ibid, [5.4].

- (e) the use of after the event insurance or other mechanisms to offset the risk of an adverse costs order and the basis upon which they will be funded by the litigation funder;
- (f) an estimate of the amount which the funded client may recover in the proceedings;
- (g) an estimate of the cost of the proceedings;
- (h) an estimate of the remuneration that the litigation funder will receive; and
- (i) an estimate of the percentage of the amount that is likely to be recovered by the client that will be paid to the litigation funder and the lawyers.

As with lawyers, this should be an ongoing obligation that requires the disclosure to be updated whenever there is a material change.

Given the requirements for costs disclosure that are already imposed on lawyers, and the detailed analysis undertaken by litigation funders before they agree to fund any proceedings, this information will be available and should be disclosed. This will enable potential clients of the funder to properly assess the funding agreement that is being offered to them and make an informed decision in relation to the costs and benefits it offers. It will also ensure that clients of litigation funders can make a proper assessment of their options as the matter proceeds.

The litigation funder should also be obliged to provide a copy of the litigation funding agreement to the court at the commencement of the proceedings. Any changes to the funding agreement (including side letters or other limited arrangements) entered into during the course of the proceedings should be provided to the court and other plaintiffs or class members within five working days of the change being agreed or communicated to the client.

Finally, a copy of the litigation funding agreement should be provided to the other parties to the proceedings when the proceedings are commenced if an order to that effect is made by the Court.

In order to ensure that these obligations apply in all funded matters, regardless of jurisdiction, they should be incorporated into a national statutory licensing system.

4.7 **Capital adequacy**

As has been observed above, little is known about the internal operations of most litigation funders. In many instances, nothing is known of the funder's financial position, let alone whether the litigation funder holds adequate capital relative to its financial obligations. There is no regulator or other agency to provide any oversight in relation to this issue, nor a mechanism to protect clients in the event of a shortfall or failure on the part of a litigation funder to honour its obligations as is the case in other industries.

The problem is exacerbated by the entry of smaller entities and individuals to the litigation funding market, many of whom lack both the experience and the resources to properly assess or manage claims. The Australian market is also seeing the entry of more foreign litigation funders with little or no presence in Australia.⁸¹ In these cases, even the minimal protections provided by, for example, the prohibition on insolvent trading, are of little or no value.

There is a real risk that an undercapitalised funder will instigate litigation and then not be able to meet the lawyer's fees during the course of a trial or satisfy an adverse costs order should the matter be decided in favour of the defendant. Both scenarios are unacceptable.

⁸¹ For example, Netherlands-based litigation funder, Omni Bridgeway, has provided litigation funding in Australian matters over the past 5 years. See, Patrick Windle, 'IBISWorld Industry Report 05446 Litigation Funding in Australia', IBIS World (February 2017) 14.

In contrast to the lack of oversight for litigation funders, insurers who meet the costs of litigation defence are regulated and supervised by the Australian Prudential Regulation Authority.⁸²

Given litigation funders are involved in the provision of a financial service and their ability to meet their obligations is dependent on their capital adequacy, this is an issue which requires both regulation and oversight.

A solution

Litigation funders are providing a financial service in circumstances where the failure of the business, or an inability to honour its obligations in full, will have very serious, if not catastrophic consequences for the client. Consider, for example, the failure of the funder in the middle of a hearing or its inability to honour an indemnity for an adverse costs order after the proceedings have failed.

In these circumstances, litigation funders should be subject to a similar degree of prudential supervision as other financial services providers, including the imposition of capital adequacy provisions.

5. Response To The Commission's Proposals And Questions In Relation To The Regulation Of Litigation Funders

Comprehensive national reform is required

The Australian litigation funding industry has created a national market and given rise to a range of issues that require a national solution.

Accordingly, ILR urges the Commission to advocate for a national solution to a national problem. It must be a solution that addresses all aspects of the litigation funding industry. Specifically, the solution must apply to all third party funding of dispute resolution proceedings, including class actions, single plaintiff litigation and arbitrations. It must also be sufficiently flexible to encompass the emerging new modes of litigation financing; for example, portfolio financing.

This is the appropriate time to pursue such a proposal. The Federal Government is engaged in a detailed review of the regulatory models used to regulate the financial services sector. There is intense public interest in ensuring that consumers who utilise financial services providers are properly protected and that the conduct of those who participate in that market is appropriate and fair.

In 2014, ILR developed and published a comprehensive proposal for the national regulation of litigation funders.⁸³ That proposal addressed a number of the concerns identified in this submission. The ILR proposal is summarised in Appendix A.

⁸² *Insurance Act 1973* (Cth), s 12.

⁸³ US Chamber Institute for Legal Reform, *An Oversight Regime for Litigation Funding in Australia*, August 2014 <<http://www.instituteforlegalreform.com/uploads/sites/1/LitinAUS.pdf>>.

Proposals 3-1 and 3-2 (Introduction of a licencing regime)

ILR generally supports Proposals 3-1 and 3-2 as proposed by the Commission.

However, ILR is also strongly of the view that any litigation funding license should also:

- (a) expressly impose a non-derogable duty on litigation funders to:
 - (i) act in the best interest of their clients, and to place the best interests of their clients ahead of their own; and
 - (ii) in circumstances where a conflict arises, prioritise the interests of their clients over their own.
- (b) include a breach reporting requirement along the lines that apply to AFSL holders under the Corporations Act and ASIC Regulatory Guide 78. Specifically, a licenced litigation funder should be required to:
 - (i) notify the regulator in writing within 10 business days of any significant breach (or likely breach) of its obligations as a licence holder. This notification obligation should apply to all licence conditions, disclosure obligations and capital adequacy requirements; and
 - (ii) maintain appropriate breach registers and compliance reporting.
- (c) require proper disclosure to clients and potential clients of the terms of the funding agreement;
- (d) address foreign litigation funders, some of whom have little or no presence in Australia. The participation of foreign funders raises questions about the ability of a client to enforce the terms of any funding agreement or take action in the event of a breach of licence conditions. Therefore, foreign litigation funders operating in Australia must, as a licence condition, expressly:
 - (i) agree that Australian law governs the funding contract; and
 - (ii) irrevocably submit to the jurisdiction of the relevant Australian court.

Who should regulate the industry?

ILR rejects any suggestion that a self-regulation model will deliver meaningful or effective regulation, let alone supervision, of the litigation funding industry and believes it would do little to address conflicts of interest issues. Australian governments have rejected this concept in relation to the regulation of the legal profession and many other, indeed most industries, as a matter of public policy. It is also clear that the self-regulation model adopted in the UK has not been effective; for example, the voluntary code of conduct applies to only a handful of litigation funders operating in the United Kingdom who have chosen to join the voluntary industry association.

The critical issues in the choice of oversight agency will be to ensure that the regulator is:

- (a) proactive in terms of its oversight and enforcement function;
- (b) adequately resourced; and
- (c) has appropriately qualified and experienced staff who can provide that oversight.

Subject to its ability to satisfy these requirements, ILR would not oppose ASIC as the regulator.

Question 3-1 (Qualifications for licensees)

Litigation funders are involved in the promotion, conduct and control of complex, commercially significant litigation in Australia, requiring the imposition of both character and qualification standards.

Litigation funders have effective control over very large litigation that can have a significant impact on markets and the fate of publicly listed corporations. There is potential for litigation, particularly class action litigation, to be misused. Litigation funders also deal with vulnerable members of the community who often become involved in class action by way of a web-site 'click to sign up' approach with minimal assistance, let alone appropriate, independent legal advice.

For these reasons, ILR believes a licence should require:

- (a) those who are involved in the management and control of the entity to meet a character test based on the 'fit and proper' criteria imposed on those applying to join the legal profession;
- (b) a financial knowledge and skills requirement of the type required of an AFS licensee running a registered scheme; and
- (c) a responsible manager who is legally qualified and holds a current practicing certificate.

The requirement for the licensee to have a responsible manager who is legally qualified and holds a current practicing certificate will ensure that the litigation funder can properly monitor and instruct the lawyers it effectively (and sometimes literally) retains on behalf of class members who are not otherwise allowed under the terms of some funding agreements, or are not in a position, to do so.

Question 3-2 (Minimum financial resources)

ILR agrees that security for costs orders do not negate the need for capital adequacy. Security for costs orders do not address the risk of the funder being unable to fully fund the costs of running an extensive, complex trial. The consequences for both plaintiffs/class members and defendants of a trial aborting due to a loss of funding mid trial can be substantial.

Litigation funders have, from time to time, asserted that there has not yet been a 'failure' of a funder in terms of it being unable to meet its obligations. Of course, the fact that there may not have been a failure as yet is hardly a reason to assume there will not be a failure in the future. At least one UK based funder has publicly acknowledged being called upon by smaller funders to take over the funding of ongoing matters where the original funder was unable to complete the matter.⁸⁴

More recently the managing director of Burford Capital, a significant foreign litigation funder, was reported as saying that "many funders won't be able to survive the inherently risky business [of litigation funding]".⁸⁵ In the current environment, where litigation investment can be made by entities whose principal business is not litigation funding, and even by individuals, capital adequacy must be established.

ILR believes that licenced litigation funders should be subject to prudential supervision to ensure that the funding vehicle has sufficient capital in Australia to satisfy its financial obligations.

⁸⁴ Observation made during panel discussion at *Increased Regulation of Litigation Funding Seminar* in Melbourne on 9 April 2018

⁸⁵ See comments in *Lawyerly* 10 July 2018 <<https://lawyerly.com.au/burford-capital-managing-director-predicts-many-litigation-funders-will-fall/>> (accessed 12 July 2018)

It is proposed that the applicable prudential requirements should include those that already exist under the AFSL regime in addition to the following further obligations:

- (a) satisfy the 'Base Level Financial Requirements' set out in ASIC Regulatory Guide 166;
- (b) comply with the minimum financial requirements that apply to specific classes of AFSL holders. For example, a litigation funder could be subject to adjusted surplus liquid fund and liquid fund requirements in circumstances where the arrangement under which it conducts business means it is obliged as principal to claimants for an amount in excess of \$1,000,000, or where the litigation funder otherwise holds property on trust for the claimants in the sum of \$100,000 or more;
- (c) satisfy ASIC that it has sufficient assets to cover the potential liabilities associated with an unsuccessful case; and
- (d) maintain liquid capital reserves equal to at least twice the amount of its investments in litigation.

ASIC should conduct an annual audit of the funder to ensure its financial soundness. This would ensure that a litigation funder is capable of paying legal fees, disbursements and any adverse costs order.

The position of foreign litigation funders raises additional complications beyond simply capital adequacy requirements. These include the ability of a client, or indeed another party, to enforce any orders or judgement made against a foreign litigation funder.

Should lawyers be allowed to enter into contingency fee agreements, consideration will have to be given to managing their ability to satisfy the additional costs obligations they will incur, including the potential to be required to satisfy an adverse costs order. In ILR's view, contingency fee agreements are not analogous to a 'no win, no pay' or conditional costs agreement.

Question 3-3 (Should a litigation funder be required to join the Australian Financial Complaints Authority scheme?)

Having regard to recent developments in other areas of the financial services industry, ILR believes litigation funders should be required to join AFCA as a condition of any licence.

6. Conflicts of Interest

6.1 Introduction

It is well accepted that conflicts of interest are a serious issue in litigation funding. The real issue is not whether these conflicts exist, but the extent and effectiveness of the way in which these conflicts are managed.

Both the Discussion Paper and earlier inquiries have identified in some detail the conflicts of interest which will inevitably arise where a litigation funder is involved in litigation.⁸⁶

The most obvious conflict is that between the interests of the litigation funder and its client(s). As a commercial enterprise, litigation funders exist to generate profits for their shareholders. Litigation funders wish to maximise the return on their investment as quickly as possible. They also wish to limit their exposure to loss. On the other hand, their clients wish to maximise their own return from the proceedings. Sometimes, the conflict faced by the litigation funder is

⁸⁶ See for example, Discussion Paper Chapter 4.

exacerbated in the case of a class action where there are often thousands of class members, each of whom may have different objectives or appetite for risk.⁸⁷

This conflict will arise throughout the proceedings where the litigation lender has taken on the role, or retains the right, to 'manage' the proceedings. It is thrown into sharp focus when there is an offer to settle the proceedings.

In the case of a lawyer, this dilemma is quickly resolved. Lawyers owe a fiduciary duty to their client(s). They must place the interests of the client(s) ahead of their own.

In contrast, litigation funders owe no fiduciary duty to their clients. Many litigation funders endeavour to also exclude the possibility of such a duty arising as a term of the contract with their clients.

The authors of one paper have expressed a contrary view,⁸⁸ suggesting that litigation funders do, in a narrow range of circumstances, owe a fiduciary duty to their clients. However, this view has not been adopted by the litigation funding industry or in the courts.

ILR is of the view that this should be put beyond doubt. At the very least, a non-derogable duty should, as previously stated, be imposed upon funders to:

- (a) act in the best interest of their clients, and to place the best interests of their clients ahead of their own; and
- (b) in circumstances where a conflict arises, prioritise the interests of their clients over their own

Lawyers as litigation funders

On at least two occasions, lawyers have endeavoured to take on the role of litigation funder in proceedings in which they are acting which has led to significant criticism and their subsequent withdrawal from those proceedings.

The well-known plaintiff law firm, Maurice Blackburn, created its own funder, the Claims Funding Australia Trust, which has as its trustee Claims Funding Australia. Two of Maurice Blackburn's senior principals are shareholders in the funder, while a third serves as one of the funder's three directors.⁸⁹ They share a registered office. In addition, all of Maurice Blackburn's principals are beneficiaries of the discretionary trust.⁹⁰ Maurice Blackburn applied to have Claims Funding Australia fund the equine influenza class action. However, they withdrew the application shortly after, as the then Attorney-General, George Brandis, said the involvement of law firms with litigation funders caused "*conflicts of interest and moral hazards*".⁹¹

Maurice Blackburn could not resolve the conflict between its status as solicitor and *de facto* funder. This ought to be no different to where an unrelated litigation funder is involved in a matter.

⁸⁷ Michael Duffy, 'Two's Company, Three's a Crowd?' (2016) 39(1) *UNSW Law Journal* Volume 165, 171.

⁸⁸ Simone Degeling and Michael Legg, 'Fiduciaries and funders: litigation funders in Australian class actions' (2017) *Civil Justice Quarterly* 244.

⁸⁹ John Emmerig and Michael Legg, 'Litigation funding in Australia a tangled web' (1 August 2013) *Company Director* 3.

⁹⁰ *Ibid.*

⁹¹ Ben Butler, 'Ponzi scheme claims against litigation funder of equine class action', *Sydney Morning Herald* (online), 22 February 2014 <<http://www.smh.com.au/business/ponzi-scheme-claims-against-litigation-funder-of-equine-class-action-20140221-337my.html>>.

Ultimately, the class action was abandoned in June 2016, as the case had little prospects of success, and the amount recovered would be entirely consumed by additional legal costs.⁹² This suggests the driver of the litigation was the remuneration of the funder and the lawyers, not the compensation potentially payable to class members.

The second case involved Melbourne City Investments (**MCI**),⁹³ a company which acquired small parcels of shares in a number of companies, including Treasury Wine Estates Limited, Leighton Holdings Limited and Worley Parsons Limited. In late 2013, MCI launched securities class actions in the Victorian Supreme Court against those companies, alleging that it, and other class members, had lost share value as a result of misleading and deceptive conduct.⁹⁴ MCI's sole director and shareholder is Mark Elliott, a Victorian solicitor, who was acting for the class in the proceedings on a "no win, no fee" basis.⁹⁵

On appeal the Court observed that:

"MCI is using the cause of action to create an income-generating vehicle for its solicitor. It has no interest in vindicating its rights, or obtaining a remedy, as such... It seems to us that this is a clear example of an abuse of process. The processes of the Court do not exist – and are not to be used – merely to enable income to be generated for solicitors."⁹⁶

While the Court of Appeal ultimately granted a permanent stay of the proceedings on the basis that it constituted an abuse of process, the case highlights the unmanageable conflicts of interest that will arise in these circumstances.

ILR believes that the conflicts that arise when a lawyer is also funding the action as a third party litigation funder, whether directly or through a related entity, are irreconcilable and unmanageable. Such arrangements should be expressly prohibited.

Attempts to address the issue of conflicts of interest

As has already been observed, in exchange for relief from the need to hold an AFSL, litigation funders are required to "properly manage" conflicts of interest. Failure to do so, and failure to follow certain procedures for managing conflicts, is an offence. Little guidance is provided as to what proper management should entail, nor is there a requirement that any types of conflicts be entirely avoided.

As previously noted there is no effective oversight by ASIC of this requirement and ILR is unaware of RG248 ever having been enforced.

⁹² Marianna Papadakis, 'Maurice Blackburn \$11 million out of pocket after failed equine flu class action', *Australian Financial Review* (online), 16 June 2016 <<http://www.afr.com/news/maurice-blackburn-11-million-out-of-pocket-after-failed-equine-flu-class-action-20160615-gpjpev>>.

⁹³ *Melbourne City Investments v Treasury Wine Estates* [2014] VSC 340 (23 July 2014).

⁹⁴ Andrew Morrison, *Riding the outer boundaries of litigation funding*, Clayton Utz (19 February 2015) <<https://www.claytonutz.com/knowledge/2015/february/riding-the-outer-boundaries-of-litigation-funding>>.

⁹⁵ *Ibid.*

⁹⁶ *Treasury Wine Estates Ltd v Melbourne City Investments Pty Ltd* (2014) 318 ALR 121; Following the findings of the primary judge who found that Mr Elliot's conduct as being in the business of buying small shareholdings in listed companies with the objective of commencing group proceedings and that his business model was likely to be dependent upon the outcome of such proceedings. See, *Melbourne City Investments v Treasury Wine Estates* [2014] VSC 340 (23 July 2014), [49].

The Federal Court's Practice Note has also sought to address the issue of conflicts of interest, requiring that:

"5.9 Any costs agreement or litigation funding agreement should include provisions for managing conflicts of interest (including of "duty and interest" and "duty and duty") between any of the applicant(s), the class members, the applicant's lawyers and any litigation funder.

5.10 The applicant's lawyers have a continuing obligation to recognise and properly manage any such conflicts throughout the proceeding."⁹⁷

However, this suffers the same problems identified in relation to the Practice Note's disclosure requirements. Moreover, absent a fiduciary duty to the client, an obligation to merely 'manage' conflicts nevertheless still permits conflicts to exist.

Managing conflicts

While there is general agreement that conflicts of interest abound in the context of litigation funding, little has been offered by way of a solution. At present, there is a patchwork approach with no overarching obligations imposed on litigation funders to address these issues beyond RG248 and no effective oversight. Given that litigation funders fund more than just class actions, the introduction of a solution directed to class actions will only add to the patchwork.

ILR believes the problem is best resolved by way of a national licensing regime that addresses conflicts in relation to all funders and in all proceedings.

7. Response To The Commission's Proposals And Questions In Relation To Conflicts Of Interest

Proposal 4-1 (Reporting on compliance with RG248)

As ILR has already observed in this submission and the Commission states in the Discussion Paper, the effectiveness of RG248 in its current form is of limited value and effectiveness.

While imposing an obligation to report annually to the regulator in relation to a funder's compliance may be an improvement on the current situation, RG248 will continue to be of limited value until compliance with its terms is enforced by a proactive regulator.

In particular, its effectiveness will be limited until such time as it is enforced in terms that ensure proper and effective disclosure of conflicts and their management to clients.

Proposal 4-2 (Definition of litigation funding)

The litigation funding industry continues to evolve in both its scope and structure. Accordingly, it is imperative that any regulatory regime or other solution is sufficiently flexible to accommodate future developments and new modes of funding.

In these circumstances, ILR supports this proposal as ensuring that the existing regulation, such as it is, is extended to new modes of funding is preferable to leaving them completely unregulated.

Proposal 4-3 (Accreditation of solicitors)

ILR supports the concept of accreditation for solicitors in class action law and practice.

Lawyers acting for defendants in class actions have observed that there is a wide variation in the experience and expertise of those acting for plaintiffs. In some instances it has been clear

⁹⁷ Federal Court of Australia, *Practice Note --- Class Actions Practice Note (GPN-CA)*, 25 October 2015, [5].

that the lawyers acting in the matter did not understand what was involved when acting in a matter where there was a large class of otherwise unrepresented class members. This, coupled with a misunderstanding of some aspects of class action practice and procedure, resulted in the parties incurring significant unnecessary costs, lengthy delays and the use of court time that could have otherwise been better employed.

Proposal 4-4 (Prohibiting interest in funders in certain circumstances)

ILR supports the amendment of the Australian Solicitors' Conduct Rules as proposed.

ILR also believes that, while the circumstances have not arisen in the past, the Commission should consider the application of a similar rule to barristers.

Proposal 4-5 (Disclosure in matters other than class actions)

ILR strongly supports the amendment of the Australian Solicitors' Conduct Rules as proposed.

Proposal 4-6 (Amendment to GPN-CA in relation to conflicts)

ILR strongly supports the concept recommended in Proposal 4-6 but notes that this would only apply to class actions in the Federal Court.

ILR believes that the same principal and obligation should apply to all funded proceedings coming before a federal court, or indeed in any other court or arbitral proceeding. This could be achieved by way of an amendment to the Australian Solicitors' Conduct Rules (**ASCR**).

If the Commission is not minded to recommend such an amendment to the ASCR, the Commission should recommend that the Attorney-General propose to the Council of Attorneys-General that similar requirements be introduced in all states and territories.

8. Commission Rates and Legal Fees

8.1 Contingency fee agreements

Lawyers in Australia are prohibited from charging contingency fees.⁹⁸

The prohibition arose from the common law crimes and torts of maintenance and champerty. Even though both common law offences were abolished in most states and territories many years ago, the ban on contingency fees has been, and remains, articulated in legislation.⁹⁹ This is underpinned by a public policy concern that contingency fees would create perverse incentives for lawyers who have a direct financial interest in decisions affecting the litigation in which they are involved.¹⁰⁰

There has long been a general view in Australia that allowing lawyers to enter into contingency fee agreements is not in the public interest. Many, including ILR, are concerned that the introduction of contingency fee agreements would inevitably exacerbate a U.S. style litigation culture in Australia which will ultimately be paid for by consumers and the public at large. In this context it is significant that the Commission, in its report into the introduction of class actions in Australia, noted that one of the key protections against the emergence of U.S. style litigation (including what it described as "legal entrepreneurs") was the fact that Australian lawyers were prohibited from entering into contingency fee agreements with their clients.¹⁰¹

⁹⁸ Discussion Paper para 5.5

⁹⁹ *Legal Profession Uniform Law*, s 183(1); *Legal Profession Act 2004 (Vic)*, s 3.4.20(1); *Legal Practice Act 1996 (Vic)*, s 99(1).

¹⁰⁰ Productivity Commission, *Access to Justice Arrangements*, Inquiry Report No 72 (2014) vol 2, 601.

¹⁰¹ Australian Law Reform Commission, *Grouped Proceedings in the Federal Court*, Report No 46 (1988), 273, 352.

The Law Council of Australia (**LCA**), the profession's peak representative body, most recently examined this issue in 2016. While a Working Party comprised almost entirely of plaintiffs' lawyers recommended the introduction of contingency fees, the proposal was overwhelmingly rejected when considered by the LCA.

In truth, virtually the only voices calling for the introduction of contingency fee agreements are plaintiffs' lawyers.¹⁰²

The risk that clients will be subjected to 'double dipping'

An issue that must be taken into account when considering whether to allow lawyers to charge on a contingency basis is the prospect of the client being charged *two* contingency or success fees: one by their lawyer and the other by a litigation funder.

This is not a theoretical possibility – it is now being seen and promoted by litigation funders in the United States with the entry of litigation funders into that market. Put simply, the litigation funder agrees to finance the matter and the lawyer agrees to act on a contingency basis. Both charge a success fee which is paid by the client. From the law firm's perspective, this reduces the need to fund the proceedings out of its resources with a consequent benefit on cash flow.¹⁰³ From the litigation funder's perspective, it further reduces the actual risk it is facing.¹⁰⁴ This practice will inevitably further erode the return actually received by the plaintiff and group members from the proceedings.

In the event that any consideration were to be given to allowing lawyers to enter into contingency fee agreements, it must be accompanied by a prohibition on clients being subjected to multiple sets of success fees in relation to the same matter.

Would allowing contingency fee agreements actually increase competition with litigation funders?

It has been suggested, including by the Productivity Commission in its review of *Access to Justice Arrangements*, that lifting the ban on lawyers charging contingency fees would create a significant source of new funding over and above that provided by litigation funders.¹⁰⁵ It has also been argued that the resultant increase in competition would place downward pressure on the remuneration charged by litigation funders.¹⁰⁶

However, this is far from certain. ILR is unaware of any empirical evidence that would support this proposition and notes that the best the Productivity Commission could say, in this regard,

¹⁰² See for example, Maurice Blackburn, Submission to the Productivity Commission, *Access to Justice Arrangements*, 8 November 2013, 6, 13 - 14.

¹⁰³ Westfleet Advisors, *Litigation Budgets & Alternative Fees for Law Firms* (2015) <<http://westfleetadvisors.com/litigation-funding-law-firms/alternative-fees/>>; American Bar Association, *Emerging Issues in Healthcare Law, Litigation Finance - Practical and Ethical Dimensions* (8 - 11 March 2017) <https://www.americanbar.org/content/dam/aba/administrative/healthlaw/21_litigation_finance_pp.authcheckdam.pdf>.

¹⁰⁴ Westfleet Advisors, *Guide to Litigation Financing*, (2015) 11, 12 <https://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2015_spring_leadership_meeting/guide_to_litigation_financing_may_2014_charles_agee.authcheckdam.pdf> .

¹⁰⁵ Productivity Commission, *Access to Justice Arrangements*, Inquiry Report No 72 (2014) vol 2, 625.

¹⁰⁶ Patrick Windle, 'IBISWorld Industry Report 05446 Litigation Funding in Australia', IBIS World (February 2017).

is that:

"At the other end of the spectrum, [contingency fee agreements] may create some competition for litigation funders" ¹⁰⁷
(emphasis added)

First, there is a real question as to the extent to which lawyers would be able to access sufficient capital to fund litigation beyond that which is already conducted on a 'no win, no pay' basis, with the potential for an 'uplift' of those fees. Law firms operating as partnerships are not well placed to raise significant capital to invest in their businesses. Related to this issue is the inevitable reluctance of lawyers to risk their own capital in litigation funding. This is reflected in the limited number of class actions in Australia that are conducted by lawyers on a 'no win, no pay' basis.

Second, contingency fee options are more likely to be offered for smaller claims – particularly those which litigation funders are unwilling to consider based on the potential size of the return.¹⁰⁸ In part this will be due to the inability of law firms to raise sufficient external capital to fund major litigation. It will also reflect the desire of most law firms to limit their potential losses if a case fails. Law firms taking on cases that litigation funders are unwilling to consider, let alone fund, will not drive an increase in competition. However, with the introduction of contingency fees, it is likely that there will be a significant increase in the number of lower value cases being commenced, with a real risk that some firms will use this as an opportunity to pursue clients and cases that would not otherwise justify being commenced. For some defendants, particularly corporate defendants, it may well be cheaper to settle these matters than defend the proceedings, regardless of the merits of the claim.

Given most personal injury claims are already conducted by lawyers on a 'no win, no pay' or conditional fee basis, the real effect of the introduction of contingency fees may be that clients receive less while their lawyers take a percentage of the proceeds of the case that would have previously flowed to their client. It is hard to see how that is in the public interest.

Third, while it is implicitly assumed by those who favour the introduction of contingency fees, it does not follow that a lawyer acting on a contingency fee basis will charge less than a litigation funder. Indeed, given they may be taking on smaller, more risky, claims, lawyers may well charge more as a proportion of the settlement/judgment.

The changes that have been implemented in the United Kingdom are instructive. In the United Kingdom, contingency fees that can be charged by a lawyer are capped at 25 percent for personal injury cases, 35 percent for employment cases, and 50 percent for all other cases.¹⁰⁹ Presumably, these caps have been set after careful consideration of the premium that would be required to encourage sufficient numbers of lawyers to adopt a contingency fee model. Given litigation funders charge around 30 percent of the total amount recovered,¹¹⁰ this suggests that there will be limited competition on fees.

Fourth, absent a legislative requirement to do so, it is unlikely that lawyers offering to act on a contingency fee basis will be willing to indemnify their clients against an adverse costs order, as do litigation lenders. This is a significant disincentive for clients entering into contingency fee agreements with a lawyer as compared to a traditional litigation funding agreement.

¹⁰⁷ Productivity Commission, *Access to Justice Arrangements*, Inquiry Report No 72 (2014) vol 2, 625.

¹⁰⁸ IMF Bentham only funds single party proceedings greater than AUD \$5 million or multi-part proceedings greater than AUD \$20 million. See, IMF Bentham, *Commercial Litigation* (2017) <<http://www.imf.com.au/practice-areas/commercial-litigation>>.

¹⁰⁹ Productivity Commission, *Access to Justice Arrangements*, Inquiry Report No 72 (2014) vol 2, 606.

¹¹⁰ Vince Morabito, 'An Empirical Study of Australia's Class Action Regimes, Second Report '(Report, Australian Research Council, September 2010) 5, 41; see also, *Earglow Pty Ltd v Newcrest Mining Limited* [2016] FCA 1433 [170].

A plaintiff in these circumstances would have to risk the consequences of an adverse costs order or purchase an ATEI policy - something which, when offered on a 'one off' basis, is likely to be prohibitively expensive. If the plaintiff is a corporation, it may face the prospect of an application for security for costs. None of these alternatives will be attractive for potential plaintiffs.

Absent a real increase in competition driven by both a real choice for consumers between two similar products and the ready availability of the alternative, there will be no significant downward pressure on the fees charged by litigation funders.

Finally, as has already been noted, the United States experience suggests that, absent some express prohibition, litigation funders are likely to work with lawyers in developing a 'hybrid' approach.¹¹¹ As a consequence, rather than driving down the cost to the funded client through increased competition, the cost to the client could well increase.

However, this is not the only issue that should be considered. The benefits to the community and access to justice flowing from any downward pressure on the fees charged by litigation funders must also be weighed against the other consequences such a change would bring.

Would allowing contingency fees agreements actually increase 'access to justice'?

Proponents for the introduction of contingency fee agreements argue that it would increase 'access to justice' by:

- (a) allowing those who cannot otherwise afford a lawyer to obtain the services of one who is willing to act on a contingency basis; and
- (b) enabling law firms to use the super profits earned by way of contingency fees in commercial litigation to cross-subsidise so called 'social justice' cases.

To state the obvious, "[l]aw firms ... [acting on a contingency basis] ... , like litigation funders, will likely only back cases they can win, limiting potential benefits to clients."¹¹² That incentive is absent where the lawyer makes an assessment that the potential action is marginal, let alone more likely than not to be lost.

One of the more audacious arguments advanced in support of the introduction of contingency fees is the suggestion that this would allow plaintiffs' firms to run more 'social justice' litigation.¹¹³ Presumably, the super profits from the successful cases will support the funding of more marginal or speculative cases where there is a risk that the case will fail. There could, of course, be no assurance that this would in fact happen. There is also a real question as to the public interest in facilitating an increase in the incidence of marginal or speculative cases – particularly in circumstances where the plaintiff or representative class member is likely to be a person who would have no prospect of satisfying any adverse costs order.

This has certainly not been the case in the United States where contingency fees have been allowed for many years, with one American commentator suggesting that,

"[b]ecause of this large personal financial stake, the attorney can no longer look upon his practice of law as one devoted primarily to justice... the contingency fee system has bred a particular type of attorney and a particular type of client who

¹¹¹ American Bar Association, *Emerging Issues in Healthcare Law, Litigation Finance - Practical and Ethical Dimensions* (8 - 11 March 2017) 6, 8, 9
<https://www.americanbar.org/content/dam/aba/administrative/healthlaw/21_litigation_finance_pp.authcheckdam.pdf>.

¹¹² Patrick Windle, 'IBISWorld Industry Report 05446 Litigation Funding in Australia', IBIS World (February 2017) 8.

¹¹³ Victorian Law Reform Commission, *Access to Justice - Litigation Funding and Group Proceedings*, Consultation Paper, (July 2017) 113 - 114.

now view the contingency system as a mechanism for high, relatively easy returns."¹¹⁴

It is also unclear why, as a matter of public policy, plaintiff law firms should determine which causes should be seen as a social justice issue and thus cross-subsidised by others chosen by those law firms.

Finally, while it is argued that allowing contingency fees to be charged by lawyers in class actions may increase competition, it is more likely the result will be the emergence of more competing class actions with the potential for overlapping classes of members. While this would give rise to a mirage of increased competition, in reality it would simply increase costs, the volume of litigation, and the pressure on Australia's already overburdened court system.

Contingency fees would drive an increase in litigation of dubious merit

While the introduction of contingency fees is unlikely to drive a significant increase in competition in the litigation funding market, it is much more likely to drive an increase in the overall volume of litigation.

Many small firms will, for the first time, have the opportunity to 'take a punt' - not just for their normal fee plus an uplift but rather for what some will see as a significant windfall profit. However, as Associate Professor Michael Legg and his colleagues have observed in the context of the class action market, an increase in the overall number of claims is likely to see a reduction in the quality and merit of new claims.¹¹⁵ In other words, more marginal claims are likely to be accepted and commenced.

It might be said that such claims will fail and the plaintiffs will be obliged to pay the defendant's costs, thereby creating a significant disincentive to commence such a claim. However, experience suggests that this is not what will happen. Most cases settle. This is because defendants are often unwilling to run the risk of losing a long and expensive trial, regardless of the real merits. Management teams do not want the distraction of litigation and there is the ever present risk of reputational damage, regardless of the true merits of the claim.¹¹⁶

In the case of a class action, the problem for a defendant is exacerbated. The class action procedure allows for the aggregation of many thousands of claims in a single proceeding, thereby exposing a defendant to an enormous amount of potential liability. This potential liability, in turn, places enormous pressure on the defendant to settle, regardless of the claim's merit. This is because defendants are loath to risk even a remote possibility of a significant judgment and because such large potential liability frequently can depress the performance of the defendant's share price.¹¹⁷

¹¹⁴ Philip J. Havers, 'Take the Money and Run: Inherent Ethical Problems of the Contingency Fee and Loser Pays Systems' (February 2014) 14(17) *Notre Dame Journal of Law, Ethics & Public Policy* 621, 625, 627.

¹¹⁵ Michael Legg et al, *New Funders and Law Firms Drive Shareholder Class Actions* (7 November 2014) Centre for Law Markets and Regulation <<https://clmr.unsw.edu.au/article/market-conduct-regulation/new-funders-and-law-firms-drive-shareholder-class-actions>>.

¹¹⁶ Lang Thai, 'Shareholder Class Actions - A Critical Analysis Of The Procedure Under Part IVA Of The Federal Court Of Australia Act' (2015) 40 *The University of Western Australia Law Review* 138, 160.

¹¹⁷ See for example, CBA's share price fall after the announcement of the heavily promoted proposed class action against the CBA in relation to its alleged failure to comply with AML/CTF legislation that is jointly promoted by IMF and Maurice Blackburn. See, Clancy Yeates, 'CBA shares slump as bank vows to fight the Austrac claims', *Sydney Morning Herald* (online) 4 August 2017 <<http://www.smh.com.au/business/banking-and-finance/cba-shares-slump-as-bank-vows-to-fight-the-austrac-claims-20170804-gxp9xp.html>>.

Thus, even in Australia with the risk of an adverse costs order, there would likely be an increase in unmeritorious claims with the introduction of contingency fees, as there is in the United States, because most cases settle.¹¹⁸

In any event, lawyers acting on a contingency fee basis are unlikely to offer to indemnify the funded client against any adverse costs order. Many potential plaintiffs will simply not have the ability to meet such an order. While the theoretical consequence of failing to meet an adverse costs order is bankruptcy, experience shows that most defendants are unwilling to take that course. It is often pointless as the failed plaintiff simply does not have the assets to justify the additional expense. There can also be the risk of significant reputational risk to a corporate defendant if it is seen to bankrupt an impecunious individual, even where it has prevailed in litigation. For these reasons, the so-called protection against unmeritorious litigation is, in many cases, illusory.

While some small law firms will suffer as a consequence of taking on unmeritorious claims on a contingency basis, many more will generate a return that will inevitably be paid by consumers and the community as a whole as those costs are passed on by defendants.

Conflicts of interest

In the Australian legal system, the lawyer/client relationship has long been recognised as a fiduciary relationship. In a fiduciary relationship one person (the client) places his or her confidence, good faith, reliance, and trust in another (the lawyer), whose advice is sought in some matter.

The essence of fiduciary obligations is that the fiduciary is precluded from acting in any way other than in the interests of the person to whom the duty to so act is owed. In short, the fiduciary obligation is one of 'undivided loyalty'.¹¹⁹ The duty of a fiduciary is "to avoid and not merely "manage" a conflict of interest or prioritise one interest over another."¹²⁰

Lord Cranworth LC formulated that rule in *Aberdeen Railway Co v Blaikie Brothers*¹²¹ as that:

"... no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect."

In a recent paper, Justice Black of the Supreme Court of New South Wales, observed "[t]he test for when a conflict arises has been expressed in various ways in the cases, but the shorthand "real [and] sensible possibility" is often applied. He then referred to three decisions:¹²²

"In Boardman v Phipps [1967] 2 AC 46 at 124, Lord Upjohn formulated the test for whether a conflict exists as whether a:

¹¹⁸ Philip J. Havers, 'Take the Money and Run: Inherent Ethical Problems of the Contingency Fee and Loser Pays Systems' (February 2014) 14(17) *Notre Dame Journal of Law, Ethics & Public Policy* 621, 627, 633.

¹¹⁹ *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 46–47.

¹²⁰ Justice Ashley Black, 'Equitable and statutory regulation of conflicts of interests and duty' (Speech delivered at the University of New South Wales Law School, 10 May 2016) 6 <http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/2016%20Speeches/Black_20160510.pdf> .

¹²¹ (1854) 1 Macq 461, 471.

¹²² Justice Ashley Black, 'Equitable and statutory regulation of conflicts of interests and duty' (Speech delivered at the University of New South Wales Law School, 10 May 2016) 6 <http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/2016%20Speeches/Black_20160510.pdf> .

“reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict.”

In Chan v Zacharia (1984) 154 CLR 178 at 198, the test was expressed as “a conflict ... or significant possibility of such conflict”. In that case, Deane J (with whom Brennan and Dawson JJ agreed) also referred to an observation of Sir Frederick Jordan in Chapters in Equity in New South Wales (6th ed 1947, p 115) that:

“It has often been said that a person who occupies a fiduciary position ought to avoid placing himself in a position in which his duty and his interest, or two different fiduciary duties, conflict. This is rather a counsel of prudence than a rule of equity; the rule being that a fiduciary must not take advantage of such a conflict if it arises.”

A moment's consideration will reveal that a lawyer who enters into a contingency fee agreement with a client will almost always, if not inevitably, find him or herself in a position of conflict with his or her client. Or, at the very least, a situation where a reasonable person would think that there was a real and sensible possibility of conflict.

These conflicts, or the appearance of a conflict, will arise throughout the life of the proceedings. Questions will arise as to whether a particular strategy should be pursued which may, if successful, result in a significant award of damages, albeit at some risk of the case failing. Lawyers may be deterred from accepting a case resolution that does not result in a monetary award. A settlement offer may be received which, while well short of what might be awarded in a final judgement, provides a faster, more certain return on the lawyer's investment and is more attractive to the lawyer than to the client.

The dilemma of the 'settle or run to verdict' question will be all the more acute when the plaintiff is impecunious, and faces no real consequences from an adverse costs order. This has been the situation in the United States with commentators, such as Philip Havers, suggesting that with contingency fees:

*"[a]s the lawyer invests more time and money, his personal stake in the outcome of the case increases and the more the lawyer's incentives begin to change. Rather than seeking a just settlement for the client which adequately compensates the client for his injuries, the attorney must also account for the increasing costs and effort expended as the suit goes forward."*¹²³

Therefore, an American commentator suggests contingency fees *"destroys the attorney-client relationship."*¹²⁴

This concern is met by two arguments on the part of those who advocate the introduction of contingency fees. First, litigation funders face exactly the same conflicts. Second, lawyers who enter into conditional fee agreements face similar conflicts.

Neither of these propositions justify the introduction of contingency fees.

While litigation funders may place themselves in the same position of conflict, they are in a fundamentally different position to a lawyer. They are not fiduciaries – indeed, most go to great lengths to exclude that possibility by agreement with their clients. They are not subject to the other ethical and professional obligations imposed on lawyers. They are not part of a

¹²³ Philip J. Havers, 'Take the Money and Run: Inherent Ethical Problems of the Contingency Fee and Loser Pays Systems' (February 2014) 14(17) *Notre Dame Journal of Law, Ethics & Public Policy* 621, 625 - 626.

¹²⁴ *Ibid.*

profession that stands for and is based on something more than merely endeavouring to make a profit from their clients. There can be no meaningful analogy between the two positions.

The argument in relation to conditional fee agreements entered into by lawyers is more difficult in the sense that a conditional agreement does give rise to a conflict. However, just because a lawyer may already face a conflict, this does not justify the introduction of a further conflict. *A fortiori* a conflict which is sharpened or made more difficult by virtue of the enormous sums that might be at stake in the case of a contingency involving a multi-million dollar potential settlement.

Ultimately, one only has to consider the prospect of litigation that is "*lawyer funded, lawyer managed and lawyer settled*",¹²⁵ in circumstances where the plaintiff's only source of information and advice about the conduct of their litigation is coming from a person with a direct, and perhaps, very significant financial interest in the outcome of the proceedings,¹²⁶ to understand why such a position is unacceptable.

Contingency fees - conclusion

Having regard to the consequences that would flow from allowing law firms to enter into contingency fee agreements, the prohibition should remain as it is in the best interests of litigants and the public to do so.

However, in the event that lawyers were to be allowed to enter into contingency fee agreements with their clients, it should be on the condition that:

- (a) there is a prohibition on both a litigation funder and the lawyer charging the client a success fee or contingency in the same matter; and
- (b) the lawyer indemnifies the client against any adverse costs order.

8.2 Commission rates in litigation funding agreements

It is generally acknowledged that the fees paid to some litigation funders, particularly when considered as a percentage of the total judgement or settlement sum, are grossly excessive. Indeed, this is one of the issues that gave rise to both this and the earlier VLRC inquiry.

It is not a new issue. Indeed, the question of what is a fair level of reward, and how that might be assessed, has been of concern to the courts since litigation funding first emerged in Australia.

It was addressed by the High Court of Australia in plain terms in *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd*¹²⁷ where three of the Justices said:

"[T]o ask whether the bargain struck between a funder and intended litigant is "fair" assumes that there is some ascertainable objective standard against which fairness is to be measured and that the courts should exercise some (unidentified) power to relieve persons of full age and capacity from bargains otherwise untainted by infirmity. Neither assumption is well founded."

To date, the issue has always arisen in the context of class actions and then usually in the context of an application for approval to settle the proceedings. As part of its consideration of such an application, the court will review the costs that will be taken from the settlement sum which will include the litigation funders remuneration.

¹²⁵ John C Coffee Jr, *Entrepreneurial Litigation: Its Rise, Fall, and Future* (Harvard University Press, 2015), 5.

¹²⁶ *Ibid.*

¹²⁷ (2006) 229 CLR 386 at [92] (Gummow, Hayne and Crennan JJ).

Of course, this is only one part of the problem. The very same issues arise in the funding of traditional, single party, litigation and arbitration proceedings. However, it is an issue that rarely arises outside class actions, as there are few occasions on which the issue might be considered by the court or tribunal. Accordingly, any solution must address not just funded class actions but all funded proceedings.

The urgency to address this issue has been emphasised by the emergence of the common fund order.¹²⁸ This has the potential to allow a litigation funder to seek an order that non-funded class members pay a premium to the litigation funder out of their share of the proceeds, even though they never entered into a litigation funding agreement. To allow a litigation funder to unilaterally impose such a premium on non-funded class members at current rates would be unconscionable.

What is currently being charged by litigation funders?

Notwithstanding both the egregious excesses highlighted by critics of litigation funding in the media and the comforting assertions of the funders themselves and their allies as to what is the 'normal range' of remuneration, the truth is that nobody really knows what is being charged.

There is no informed, competitive market for litigation funding services. As previously noted in this submission, there is a lack of transparency and no apparent consistency in how remuneration is structured in terms of commission and other charges such as project or management fees. As a consequence, most consumers are unable to make an informed choice between competing products let alone negotiate on terms.

Recent evidence suggests that disclosures to clients and the courts may be less than complete and what is disclosed is often only available to the clients in a particular proceeding. A survey of settlement approvals and judgements in class actions in both the Federal and State Supreme Courts¹²⁹ revealed it was difficult, if not impossible, to calculate the percentage of the award of damages consumed by funder remuneration as compared with legal fees and other costs.

This is unacceptable and not conducive to ensuring that the costs of funded litigation are fair and reasonable let alone ensuring meaningful access to justice for the Australian community. It also makes it very difficult to analyse the effectiveness of competing solutions.

The approach of the courts

When courts have considered the issue of limiting litigation funding fees in the context of class action proceedings, they have adopted several different approaches.

In *Money Max Int Pty Ltd v QBE Insurance Group Ltd (Money Max)*,¹³⁰ the Federal Court supported the notion of capping the total amount received by the litigation funder in certain circumstances, including where:

- (a) there is no cap on the aggregate dollar amount receivable under the litigation funding agreement; and
- (b) a larger than expected settlement is received, which does not result in increased risk to the litigation funder.¹³¹

¹²⁸ *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Limited* (2016) 245 FCR 191.

¹²⁹ Undertaken on behalf of ILR by Clayton Utz

¹³⁰ *Money Max Int Pty Ltd v QBE Insurance Group Ltd* (2016) 245 FCR 191.

¹³¹ *Ibid*, 209 [80], [82], [86], [91], [147].

In *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Rec and Mgr apptd) (In liq) (No 3)*,¹³² Justice Beach observed that the use of a sliding scale would better ensure that litigation funders receive a share of settlement proportionate with the risk and investment.¹³³ Justice Beach also suggested:

*"that a 30% rate would be difficult to justify on a net settlement sum above \$50 million. But valuable services such as that which a funder provides have a commercial cost and if it can be justified, so be it."*¹³⁴

Finally, in *Stewart, in the matter of Newtronics Pty Ltd*,¹³⁵ the Federal Court noted it was important to ensure the entity providing the funding was not given a benefit "*disproportionate to the risk*" undertaken or a "*grossly excessive profit*".¹³⁶

This *ad hoc* approach, requiring a court to decide what might be appropriate litigation funder remuneration each time a settlement comes before it for approval, is not the answer. By this time, the parties have agreed on an outcome and no one has any interest in delaying or derailing the settlement. Furthermore, a judge may not be the right person to make this assessment. They do not have sufficient information and are ill equipped to assess the risk reward calculus. Finally, as has already been noted, the mechanism really only operates in the context of a class action.

The imposition of a cap

From time to time it has been suggested that a cap be imposed on the total remuneration that can be charged by a litigation funder as a percentage of the damages awarded to the claimant or class members. In some proposals this is extended to include both funder and remuneration and legal fees.

This idea was most recently considered by the VLRC in its report delivered in March 2018.¹³⁷ In that report the VLRC rejected the proposal, preferring to leave the issue to the court.

While there are significant issues in terms of leaving the issue to the courts, ILR shares the VLRC's concerns with a cap. Specifically, there is a real risk that the cap will become the *de facto* standard for all cases regardless of differences among cases, with the result that funded class members could be left with less compensation than they might otherwise receive. For this reason ILR has real concerns in relation to the adoption of a statutory cap.

Possible solutions

This issue is best addressed by legislation identifying the criteria to be taken into account in determining whether the remuneration being charged by the litigation funder is fair given all the circumstances. The following criteria should be taken into account:

- (a) in the case of a pre-verdict settlement, the stage the proceedings have reached;
- (b) the amount the litigation funder has invested in the proceedings – to be reflected in the litigation funder's ROI;

¹³² [2017] FCA 330 (31 March 2017).

¹³³ *Blairgowrie Trading Ltd v Allco Finance Group Ltd (in liq) (No 3)* [2017] FCA 330 (31 March 2017), [157]–[160].

¹³⁴ *Ibid*, [160].

¹³⁵ [2007] FCA 1375 (28 August 2007).

¹³⁶ *Stewart, in the matter of Newtronics Pty Ltd* [2007] FCA 1375 (28 August 2007), [26].

¹³⁷ Access to Justice - Litigation Funding and Grouped Proceedings - see paras 3.86 - 3.88.

- (c) the total amount awarded to the plaintiff by way of verdict or settlement before the deduction of legal costs and the litigation funder's remuneration; and
- (d) an assessment of the risk taken by the litigation funder in funding the proceedings which would include consideration of any steps taken by the funder to off-set its risk, for example, after the event insurance and the way it funded the insurance.

While the last criterion may be seen as difficult to assess, it is important to ensure that the remuneration charged by a litigation funder is not excessive in circumstances where the real risk is very low. ILR is aware of cases where class actions have been commenced in circumstances where the defendant was already engaged in settlement negotiations with the class members and had, at the time the proceedings commenced, paid substantial sums in settlement of claims. The defendant had conceded liability and thus, when proceedings commenced, resolution really only involved negotiation of a settlement to be approved by the court.

In these circumstances, it would be unconscionable for the litigation funder to charge a significant percentage of the settlement sum. The return should also reflect the extent to which the litigation funder has either 'carved out' part of the risk, for example by declining to offer an indemnity for adverse costs, or 'set off' part of the risk, such as with an ATEI policy. It will be important to ensure that this criterion is not seen as an invitation to reward speculative actions or those with little legal merit but with the prospect of a windfall gain if successful, should the defendant decide to settle the matter.

If this assessment is not to be left to the court or tribunal that hears the funded proceeding, it could properly be undertaken by utilising the well established procedures that have been developed for assessing lawyer's costs and determining costs disputes as between lawyer and client.

Finally, limits should be imposed on the entitlement of a litigation funder to take an excessive proportion of the total amount of very large awards of damages, particularly in catastrophic personal injury matters. Specifically, limits should be imposed on the right of a litigation funder to take a percentage of the amounts awarded to a plaintiff in a personal injuries action for future economic loss and future medical, and other care, expenses. In a catastrophic injury claim, these heads of damage can give rise to the award of substantial sums. It is simply unconscionable for a litigation funder to take a 'windfall profit' from the plaintiff in these circumstances. This is particularly so given that, in many of these cases, the risk of the proceedings failing to garner a financial return is very low.

9. **Response To The Commission's Proposals And Questions In Relation To Contingency Fees And Commission Rates**

Proposals 5-1 and 5-2 (Contingency fees)

ILR strongly opposes Proposals 5-1 and 5-2 recommending the removal of the prohibition on solicitors entering into contingency fee agreements with their clients.

In the event the Commission adopts these proposals or a variation that involves removing the prohibition on solicitors entering into contingency fee agreements with their clients, ILR believes the limitations that have been proposed are essential.

Question 5-1 (Carve out of some matters from a contingency fee regime)

As previously stated, ILR strongly opposes the removal of the prohibition on solicitors entering into contingency fee agreements with their clients in any circumstances.

ILR believes it would be difficult, if not impossible, to effectively carve some matter types from a contingency fee regime, given the blending of claims and remedies that occur in many matters.

Consider for example a prohibition on 'personal injury' matters. It is not clear if this carve out would apply to a product liability class action that included claims for damages for both personal injuries and breach of contract in relation to the sale of an implantable medical device, where part of the claim involved the cost of a replacement device.

Similarly, it is unclear if it would apply to the recent class actions involving detainees on Manus Island where the remedies pleaded included damages for both false imprisonment and physical and psychological injury.¹³⁸

Proposal 5-3 (Power to vary or set commission rates)

ILR supports Proposal 5-3 and, if the prohibition on solicitors entering into contingency fee agreements with their clients is removed in whole or in part, believes it should be applied equally to contingency fees.

ILR is concerned there may be doubt as to the Court's power to make such an order as the legislation currently stands and believes that any doubts should be removed.

ILR believes the ability of a court to make such an order should not be restricted to class actions in the Federal Court. Rather, the same power should be available to all courts in relation to all funded proceedings coming before a federal court or, indeed in any other court or arbitral proceeding.

Accordingly, ILR submits that the Commission:

- (a) amend the proposal, such that the same power should be available to all courts in relation to all funded proceedings coming before a federal court; and
- (b) recommend that the Attorney-General propose to the Council Of Attorneys-General that similar powers be introduced in all states and territories.

Question 5-2 (Limits on commission rates)

For the reasons set out above, ILR does not support the introduction of a blanket statutory cap on contingency fees or a litigation funder's total remuneration (not just 'commission').

Rather, ILR believes a more flexible approach is required which would involve

- (a) in the case of a pre-verdict settlement, the stage the proceedings have reached;
- (b) the amount the litigation funder has invested in the proceedings – to be reflected in the litigation funder's ROI;
- (c) the total amount awarded to the plaintiff by way of verdict or settlement before the deduction of legal costs and the litigation funder's remuneration;
- (d) an assessment of the risk taken by the litigation funder in funding the proceedings, including consideration of any steps taken by the funder to off-set its risk, for example, obtaining after the event insurance, and the way that this was funded; and
- (e) a mechanism for limiting the percentage of damages that can be taken by the funder in personal injury matters, particularly those involving catastrophic injuries.

Given the emergence of the common fund order,¹³⁹ which means that even fewer cases will involve even a pretence of the class members being able to negotiate terms with the funder

¹³⁸ See Fourth Amended Statement of Claim in *Kamasae v The Commonwealth of Australia & Ors* SCI 2014 06770

¹³⁹ See *Money Max supra*

before the case is commenced, this is a critical issue in ensuring that consumers are adequately protected.

Question 5-3 (Imposition of statutory cap)

ILR believes the same approach should be taken to contingency fee agreements if the prohibition on solicitors entering into contingency fee agreements with their clients is removed.

Question 5-4 (Class action reinvestment fund)

ILR does not support the introduction of a class action reinvestment fund or similar entity.

First, if a claim is in fact truly 'meritorious' it will be funded by a funder or on a 'no win, no pay' basis. There is no evidence to suggest that this is not the case. ILR notes that no class action claimants have made an application to the Victorian Law Aid fund for support.¹⁴⁰

Second, absent a significant injection of government (tax payer) funding, it is unlikely that any fund relying on a tax or levy of one percent of fees recovered from contingency or litigation funding agreements will build a sufficient capital base, in the short to medium term, capable of providing meaningful support.¹⁴¹

Third, while the source of funds may be portrayed as a tax or levy on the proceeds of fees recovered from contingency or litigation funding agreements it would, in truth, be a tax or levy on successful claimants who have already given up a very significant proportion of their damages to the funder or lawyer acting on a contingency fee agreement. The creation of a fund thwarts the concept that damages are intended to compensate the plaintiffs in that case.

10. **Competing class actions**

The problem of competing class actions has become a significant issue in Australia. It is a problem that will inevitably be exacerbated should the prohibition on solicitors charging on a contingency fee basis be removed.

The simple fact is that class actions in Australia are seen as a profitable investment for both funders and lawyers. As a consequence, the fact that a class action has already been commenced by one funder/firm and, as a consequence, the rights of class members protected is not seen as a reason for others to refrain from commencing their own proceedings in relation to what is, in truth, the same event and cause of action.

The experience of CBA in relation to its dealings with AUSTRAC and AMP Limited in relation to events canvassed in the Banking Royal Commission are but two recent examples of this problem.

The problems and unfairness competing class actions create have been well documented by scholars, law reform commissions and the courts,¹⁴² including:

- increased costs for both plaintiffs and defendant;
- waste of already-scarce court resources;
- increased delay;

¹⁴⁰ VLRC Report para 5.131

¹⁴¹ The Ontario Class Proceedings Fund charges a fee capped at 10% of the settlement amount. While Law Aid is entitled to charge a fee of 10% the common charge is said to be 5.5% - See VLRC Report paras 5.130 and 5.134

¹⁴² See for example the collection of material in the ALRC Discussion Paper at paras 6.5 to 6.10

- confusion and, in some instances, additional stress for putative class members; and
- the dissipation of funds that might otherwise be available to class members.

The response of the courts to the problem has been mixed. Some courts have been willing to decisively resolve the issue by selecting one matter to proceed and staying the others.¹⁴³ Others have allowed multiple actions to continue in parallel.

The problem is exacerbated when competing class actions are commenced in different jurisdictions, such as the five open (opt out) class actions that have been commenced against AMP Limited - four in the Federal Court and one in the Supreme Court of New South Wales (**SCNSW**).¹⁴⁴

Justice Stephenson in the SCNSW refused an application to transfer the class action in that Court to the Federal Court where they could be consolidated. The Court then invited the applicants in the other four cases to consider agreeing to transfer their matters to the SCNSW where, presumably, it would consider staying one or more. In the absence of such an agreement the Court indicated that it would consider issuing an anti-suit injunction to restrain the proceedings in the Federal Court.¹⁴⁵

Three days later, the four class actions in the Federal Court came before Justice Lee who invited the parties in those proceedings to consider applying for an anti-anti-suit injunction to restrain the SCNSW from issuing an anti-suit injunction.¹⁴⁶

Justice Stephenson observed in the closing words in his judgment threatening the anti-suit injunction that:

*"Common sense should prevail."*¹⁴⁷

Given the potential profits to be made by the funders and lawyers, it is unlikely common sense alone will provide a solution. Indeed, had common sense prevailed the problem would not have arisen in the first place. Similarly, with the greatest respect to the SCNSW, the approach of the Court is not an adequate response to the problem.

A better solution must be found which will work across jurisdictions and is not dependent upon the cause of action or claims being litigated.

In other words, the solution must be capable of dealing with competing class actions that have been commenced in the Federal Court and/or in one or more state or territory courts. It must also be applicable to any class actions and not, restricted to, for example, shareholder class actions. For these reasons ILR prefers the approach proposed by the VLRC.¹⁴⁸

¹⁴³ See for example the decision of Lee J in *Perera v Getswift Limited* [2018] FCA 732.

¹⁴⁴ See the decision of Stevenson J in *Wigmans v AMP Ltd* [2018] NSWSC 1045

¹⁴⁵ *Ibid* para 55.

¹⁴⁶ See report in *Lawyerly* < <https://lawyerly.com.au/amp-class-action-turf-war-escalates-threat-anti-anti-suit-injunction/> > (accessed 12 July 2018).

¹⁴⁷ *Ibid* para 56.

¹⁴⁸ VLRC Report paras 4.89 - 4.98 and Recommendation 12.

11. **Response To The Commission's Proposals And Questions In Relation To Competing Class Actions**

Proposal 6-1 (Amendments to the *Federal Court of Australia Act 1976*)

ILR believes that any proposal to deal with the issue of competing class actions must effectively address the problems of competing class actions in more than one jurisdiction in Australia, as outlined above.

Proposal 6-2 (Amendments to GPN-CA)

ILR believes that any proposal to deal with the issue of competing class actions must effectively address the problem across all competing class actions in more than one jurisdiction in Australia and not just in the Federal Court.

Question 6-1 (Exclusive jurisdiction for Federal Court in corporations matters)

The ILR does not support the suggestion that the Federal Court should be given exclusive jurisdiction with respect to civil matters, commenced as representative proceedings, arising under the *Corporations Act 2001 (Cth)*, and/or the *Australian Securities and Investments Commission Act 2001 (Cth)*, if this is only being proposed in an effort to address the issue of competing class actions.

First, while this may address the issue of competing shareholder class actions that are commenced in a state or territory jurisdiction, it leaves the very same problem unresolved for class actions involving any other subject matter or legislation.

Second, it is contrary to the policy objectives of the *Jurisdiction of Courts (Cross-vesting) Act 1987*, which has delivered substantial benefits to litigants in Australia and avoided many of the difficulties encountered in other multi-jurisdictional countries.

ILR believes the VLRC's recommendation, that the Council of Attorneys General work to establish a cross-vesting judicial panel for class actions, is sound. The judicial panel would then make decisions regarding the cross-vesting of class actions, where multiple class actions relating to the same subject matter or cause of action are commenced in different jurisdictions.¹⁴⁹

12. **Settlement Approval and Distribution**

In a funded class action it is often the litigation funder and, to a lesser extent, the lawyers acting for the plaintiff, that determine, or at the very least have significant influence over decisions in relation to settlement. Accordingly, the court has an important role to play in protecting the interests of class members, particularly those who may not have a direct relationship with the funder and/or lawyer.

The role of the court in this regard will become increasingly important with the emergence of the common fund order as the need for the funder to engage directly with most class members is reduced if not removed entirely.

Settlement principles

Having regard to the development of settlement criteria by the courts, ILR does not believe that legislative criteria are required.

¹⁴⁹ VLRC Report paras 4.89 - 4.98 and Recommendation 12.

However, as previously noted,¹⁵⁰ ILR supports clarification of the Court's power to review and set funding fees and commissions by way of a legislative amendment.

Oversight over costs and charges

ILR has already noted the difficulties courts face in attempting to assess the fairness of fees and charges imposed by litigation funders.

The courts face similar challenges in assessing the reasonableness of legal costs incurred by those acting for class members at a settlement approval hearing. While the sums involved are usually significant, little information is available let alone a detailed assessment of those costs. Where an assessment of the costs is provided, that assessment is usually prepared by an assessor appointed by the plaintiff's lawyers. In those circumstances, it can hardly be said that the report is 'independent'.

At the same time, there is usually little motivation for the parties that are before the court to delve into the issue of costs. Those acting for the plaintiffs want them paid in full and the defendant will usually see the legal costs as a component of total settlement sum that has been agreed.

This problem will only be exacerbated should solicitors be allowed to charge a contingency fee on a common fund basis. In these circumstances, the costs incurred or work undertaken will not have been subject to any scrutiny by a 'client' or litigation funder.

Administration of settlement distribution

Once a dispute has been settled, the administration of the settlement is more administrative than legal. While there may be issues of entitlement or quantum to be assessed or determined within the framework of the settlement, it does not follow that the entire administration should be left in the hands of lawyers.

The Sydney Water Financial Claims class action (that followed the suspected contamination of Sydney's water supply) provides a useful example. The settlement involved calling for, receiving and assessing a very large number of financial loss claims from both businesses and individuals. Claims ranged from the cost of replacing a burnt out kettle to extensive business interruption claims from businesses across the Sydney basin.

The administration of the settlement, which included receiving and assessing extensive accounting information and other material, was outsourced to a firm of loss assessors who completed the task quickly and efficiently at far lower cost than if it had been administered by any of the lawyers involved in the matter. Where a legal issue arose for determination, the question was referred to the parties' lawyers. If not resolved by agreement, the matter was referred to senior counsel acting as an independent referee. Very few matters were not resolved by consensus.¹⁵¹

ILR believes that using independent organisations with experience in assessing and administering large numbers of claims is the preferable course.

Settlement confidentiality

ILR notes that the Commission is not questioning the confidentiality of settlements generally but rather is restricting its consideration of class action settlements that are subject to court approval.

ILR supports the confidentiality of settlements for a number of reasons.

¹⁵⁰ See ILR's response to Proposal 5-3

¹⁵¹ Stuart Clark of Clayton Utz acted for Sydney Water.

First, maintaining confidentiality of settlements assists in the early resolution of claims. It is in the public interest for litigation to be settled as quickly as possible, as this ensures that unnecessary costs are avoided, and the burden on courts, a public cost, is reduced. This would not necessarily be the case if the terms of a settlement were made public given the potential to encourage further claims.

Second, defendants settle proceedings for a variety of reasons that extend well beyond questions of legal liability. For example, a claim may well be settled notwithstanding the absence of any liability, in order to avoid the cost and disruption associated with defending the proceedings. Similarly, the quantum of a settlement may not reflect the actual liability of the defendant. A premium may be paid to resolve a matter because the impact a claim, albeit a claim without merit, may be significant to a corporation and its ongoing business operations. If confidentiality cannot be maintained, there will be greater pressure on corporations to simply leave the determination of the matter to the court.

However, in the case of class actions, ILR acknowledges the need for disclosure to the court which will inevitably result in some level of public disclosure.

Transparency of litigation funding arrangements

As ILR has already noted, little is actually known about the terms on which many cases are funded by litigation funders. It is often difficult, if not impossible, to determine the real cost to class members in terms of the litigation funder's fees and charges from the approval decision. This is not in the public interest as it effectively operates to inhibit competition and an informed market.

ILR believes that the court's decision in a settlement approval hearing should include sufficient information to allow the reader to ascertain:

- (a) the fees and charges paid to the litigation funder; and
- (b) the percentage of the compensation or damages received by the class that has been deducted to pay:
 - (i) the litigation funder's commission, fees and charges however described; and
 - (ii) legal costs and disbursements.

13. Response To The Commission's Proposals And Questions In Relation To Settlement Approval And Distribution

Proposal 7-1 (Oversight of costs)

ILR supports the proposal that a referee be appointed to assess legal costs and the work undertaken by solicitors as proposed.

ILR believes that assessment should include all costs and disbursements including fees charged by experts and counsel.

Question 7-1 (Administration of settlement distribution)

ILR believes that settlement distribution should be subject to a tender process.

Tenders should be called in a form agreed by the parties once the terms of the settlement have been resolved.

The outcome should be decided by the Court after an assessment of the tenders by a Registrar of the Court.

Question 7-2 (Confidentiality of Settlements)

ILR believes that, as a general rule, it is in the public interest that the confidentiality of settlements should be respected.

The Court's decision in a settlement approval hearing should include sufficient information to allow the reader to ascertain:

- (a) the fees and charges paid to the litigation funder; and
- (b) the percentage of the compensation or damages received by the class that has been deducted to pay:
 - (i) the litigation funder's commission, fees and charges however described; and
 - (ii) legal costs and disbursements.

14. Regulatory Collective Redress

As the Commission notes in the Discussion Paper, extensive debate and discussion has occurred internationally over many years in relation to protecting and vindicating the rights of consumers and others in circumstances involving multiple claimants. The extensive debate in the European Union regarding collective redress is but one example.

Class actions, however they might be described, offer one solution. However, as the Commission notes in the Discussion Paper, there has been growing interest in alternative solutions.

Perhaps the strongest motivator is a fear of what is usually described as the "excesses of US style [class action] litigation". It is significant that every proposal to introduce a class action or collective redress regime devotes a good deal of effort to explaining why the scheme being proposed will not lead the jurisdiction down that path.¹⁵²

Other reasons for seeking alternatives are enumerated in the Discussion Paper:

- class actions are expensive;
- class actions take time to resolve;
- transaction costs where damages are modest may be excessive; and
- despite the stated intention of improving access to justice, barriers remain.

While this may all be true, any consideration of the alternatives deserves detailed consideration given the consequences for and cost to business and the broader community should any particular alternative be adopted.

ILR does not believe that raising one alternative solution as an addendum to an inquiry into litigation funding and class actions is the appropriate way to develop an alternative mechanism for collective redress. There is insufficient information let alone analysis of this complex issue to make a meaningful assessment.

¹⁵² Australian Law Reform Commission, *Grouped Proceedings in the Federal Court*, Report No 46 (1988), 350 - 353; The Hon Michael Duffy Federal Court of Australia Amendment Bill 1991 (Cth) second reading, House of Representatives, Parliamentary Debates, Hansard, 14 November 1991, 3174; European Union Explanatory Memorandum to COM(2013) 401 *Towards a European Horizontal Framework for Collective Redress*

For example, the Discussion Paper outlines the way in which a collective redress scheme operates in the United Kingdom under the terms of the *Consumer Rights Act 2015* (UK) (**CRA**) but does not address similar schemes operating in other parts of the European Union. The Discussion Paper offers no information or analysis on the operation of the CRA nor the impact it has had on either consumers or business.

In these circumstances, ILR believes the better approach would be to adopt the course that the Commission has taken, in relation to its concerns with the continuous disclosure regime in Proposal 1-1, and recommend to the Australian Government that it refer the question of alternatives separately to the Commission for proper consideration.

Nevertheless, since the Commission has raised the issue, ILR will briefly identify several concerns.

Yet another layer of regulation and cost

ILR is concerned that what is proposed would be yet another means to resolve disputes which businesses would be forced to address in an already crowded field.

In addition to private litigation, both class action and single party actions, a number of regulators already have the power to commence proceedings or accept enforceable undertakings from business. As ILR understands the proposal, none of the existing redress mechanisms would be replaced. Rather, yet another mechanism would be added to the mix.

Mechanism must be truly voluntary

ILR presently understands the proposal to mean that any decision to utilise the collective redress mechanism and enter into a redress scheme would be voluntary. However, that ignores the pressure that can be brought to bear on a corporation by regulators, the political process or social media to use a particular mechanism or resolve a dispute in a particular way.

It also ignores the potential for a regulator to bring pressure to bear on a corporation to agree to establish a redress scheme or face a harsher regulatory response. ILR would not support the introduction of a collective redress mechanism that could effectively be mandated by a regulator without an adequate opportunity for the corporation to challenge or test both issues of liability and the quantum of any compensation.

Mechanism lacks certainty and finality

Participation in a collective redress scheme would be voluntary. Consumers or others entitled to compensation under the scheme would not be obliged to take up the offer and could elect to take other action, for example by way of a class action.

Unlike a judgement or settlement in an open class action, a redress scheme could not deliver finality by extinguishing the cause of action. Compare this to the Sydney Water Financial Loss Class action where, at the conclusion of the settlement scheme, all claims had been satisfied, thereby delivering both compensation to those affected by the incident and certainty and finality to the defendant.¹⁵³ While this was achieved using the class action mechanism, the transaction costs and legal fees were comparatively low as the proceedings were resolved within a very short time after the action was commenced.

Establishing a redress scheme likely to trigger litigation

A defendant's voluntary participation in any redress scheme would facilitate implied admissions of liability which, when combined with a lack of any 'safe harbour', would inevitably lead to the commencement of a class action. Such an action would be justified by its promoters on the basis that the compensation offered under the redress scheme was 'inadequate' and that consumers would only receive 'fair compensation' through litigation.

¹⁵³ Schokman v Sydney Water Corporation Limited, Federal Court of Australia, Proceeding No NG 794 of 1998

This has already occurred in the context of compensation schemes established in the context of failed implantable medical devices where class actions have been commenced notwithstanding the establishment of a scheme by the manufacturer to pay for revision surgery and compensate the patient for the additional pain and suffering.

Implied admission of liability has consequences

Regardless of the terms of any legislation establishing a redress mechanism, the implied admission of liability may have significant consequences. First, the 'knock on' effect of such an admission in the Australian market may have very significant consequences in other countries from both a regulatory and liability perspective. There may also be real issues in terms of the ability of the corporation that established the scheme to call on its insurance cover.

15. Response To The Commission's Proposals And Questions Relating To A Possible Regulatory Redress Scheme

Proposal 8-1

ILR does not support a recommendation that the Australian Government consider establishing a regulatory redress scheme in the absence of a proper inquiry to consider such a scheme.

If the benefits of a regulatory redress scheme are to be considered that should occur in the context of an appropriate review rather than as an addendum to the current Reference.

Question 8-1

For the reasons set out earlier in the submission, ILR does not believe that sufficient consideration or analysis has been undertaken to allow a proper response to this question at this time.

1 August 2018

APPENDIX A

A NATIONAL LICENCING REGIME FOR LITIGATION FUNDERS

Overview

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

A licencing regime could be implemented by way of introduction of a new category of licence into Chapter 7 of the Corporations Act.

ASIC should be the designated regulatory body responsible for the administration and enforcement of this licencing regime. ASIC should be empowered to exercise the powers and discretions it presently exercises over the AFSL regime. This should include the authority to:

- (a) licence litigation funders;
- (b) enforce any applicable rules and Regulations governing litigation investments as required by the relevant licencing regime;
- (c) commence enforcement proceedings and take action for non-compliance with the relevant licencing regime; and
- (d) issue both public and private instruments of relief regarding compliance with licence conditions.

Conditions imposed on a licenced litigation funder

As a licence holder, a litigation funder should be required to comply with the specific conditions of its licence.

The conditions that will apply should, at a minimum, address the eight matters set out below.

Capital adequacy requirements

A licenced litigation funder should be subject to prudential supervision to ensure the funding vehicle has sufficient capital in Australia to satisfy its financial obligations.

It is proposed that the applicable prudential requirements should include those that already exist under the AFSL regime in addition to further obligations set out below:

- (a) satisfy the "*Base Level Financial Requirements*" set out in ASIC Regulatory Guide 166;
- (b) comply with the minimum financial requirements that apply to specific classes of AFSL holders. For example, a litigation funder will be subject to an adjusted surplus liquid fund and liquid fund requirements in circumstances where the arrangement under which it conducts business means it is obliged as principal to claimants for an amount in excess of \$1,000,000, or where the litigation funder otherwise holds property on trust for the claimants in the sum of \$100,000 or more;
- (c) satisfy ASIC that it has sufficient assets to cover the potential liabilities associated with an unsuccessful case; and
- (d) maintain liquid capital reserves equal to at least twice the amount of its investments in litigation. ASIC should conduct an annual audit of the funder to ensure its financial soundness. This would ensure that a litigation funder is capable of paying legal fees, disbursements and any adverse costs order.

Disclosure rules

A licenced litigation funder should 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.

On this basis, it is proposed that a licenced litigation funder should be required to issue a Product Disclosure Statement (**PDS**) containing similar requirements to the current obligations applicable to AFSL holders. That PDS must, at a minimum:

- (a) set out the following matters:
 - (i) dispute resolution procedures that would apply in the event of a dispute or disagreement between a claimant and the litigation funder;
 - (ii) how a claimant may raise concerns in relation to the funding arrangement;
 - (iii) how a claimant may obtain independent legal advice; and
- (b) disclose the following information:
 - (i) the identity and relevant interests of all members of the litigation funder's Board of Directors, Senior Executive Officers and funders;
 - (ii) how costs will be calculated, including the litigation funder's fees;
 - (iii) in the event that the proceedings are concluded by way of settlement, the settlement amount, the way in which the proceeds of settlement are distributed as between the claimants, the instructing lawyers and the litigation funder (including amount distributed to members and median distribution to funders).

These disclosure requirements should be included as a condition of a litigation funder obtaining (and maintaining) the licence.

Breach reporting

A licenced litigation funder should be subject to the existing breach reporting requirements that apply to AFSL holders under the Corporations Act and ASIC Regulatory Guide 78.

On this basis, it is proposed that a licenced litigation funder should be required to:

- (j) notify ASIC in writing within 10 business days about any significant breach (or likely breach) of its obligations as a licence holder. This notification obligation should apply to all licence conditions, disclosure obligations and capital adequacy requirements; and
- (k) maintain appropriate breach registers and compliance reporting.

Minimum content of litigation funding agreements

A licenced litigation funder that purports to enter into a funding arrangement, must ensure that the arrangement is covered by an agreement in writing that addresses the following matters:

- (a) an indemnity in favour of the claimant to pay any adverse cost orders;
- (b) disclosure of the fees payable to the funder, including an estimate of costs;

- (c) identification of the obligations and rights of the litigation funder, in particular, the level of control over decision making in the litigation and termination rights;
- (d) identification of the obligations and rights of the instructed lawyers;
- (e) disclosure of any contractual or other relationship between the funder and the lawyer; and
- (f) identification of the obligations and rights of the potential claimant. The ability to control significant decisions relating to the proceedings, such as those that may settle the proceedings or that increase the cost or duration of the proceedings, must be reserved to the claimant.

Compliance obligations

A licenced litigation funder should be required to implement policies and procedures that ensure licensees comply with the licence conditions. This should include an obligation on licenced litigation funders to train their employees on compliance practices and procedures.

Best interest obligation

A licenced litigation funder who enters into a funding arrangement should be under a non-derogable duty to:

- (a) act in the best interest of its clients, and to place the best interests of its clients ahead of their own; and
- (b) 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 who enters into a funding arrangement should be under a duty in relation to conflicts of interest that might arise in the course of that arrangement. That duty should have two arms:

- (a) first, a general duty to maintain adequate practices for managing any conflict of interest (as presently applies to funder vehicles that hold an AFSL); and
- (b) second, a specific duty to avoid conflicts of interest with the claimant in the following two circumstances:
 - (i) where the litigation funder and the instructing law firm share a common financial interest through ownership (of the funder by the law firm or of the law firm by the funder) or other joint economic interest in the outcome of the litigation; and
 - (ii) where the litigation funder purports to issue instructions to the lawyers on the scheme they are funding over decisions relevant to the claim.

It is submitted that in those prescribed circumstances, the conflict of interest cannot be managed, and for this reason, a duty to avoid the conflict (i.e., a prohibition on the prescribed conduct) should operate.

In addition, a licensed litigation funder that has opted to bring an open class action proceeding, should be required to take measures to ensure that the interests of class members that have not entered into a funding agreement, are still adequately protected. The litigation funder should be required to designate and pay for a representative for non-funded claimants, approved by the Court, to advise the Court in relation to any proposed arrangements in a settlement or other resolution of the proceeding.

Appointment of claimants representative

A licenced litigation funder who enters into a funding arrangement should be required to designate a claimant from the class to serve as the claimants' representative, subject to approval by the Court. This would go some way to preventing litigation funders from indirectly controlling the instructions given by claimants to lawyers about the conduct of the case.

An Alternative Approach: Extension of AFSL regime

As an alternative to the separate licencing regime proposed above, regulation of the industry could be achieved by requiring litigation funders that operate in Australia (and any person involved in providing services to litigation schemes) to hold an AFSL. That change could be achieved by amending the definition of "*financial product*" in the Corporations Act to include "*litigation funding investment schemes*" such that litigation funders (and any person involved in providing services to litigation funding schemes) would be required to hold an AFSL to operate in Australia. In addition, r 7.6.01(1)(x) and (y) of the *Corporations Regulations 2001* (Cth) should be repealed to remove the AFSL exemption applicable to litigation funders.

If this approach is preferred, the obligations imposed on ordinary AFSL holders would automatically apply to licenced litigation funders. To the extent that the eight matters prescribed above are not reflected in the existing AFSL regime, these could be introduced as conditions of a litigation funder obtaining and maintaining a licence.