US Chamber Institute for Legal Reform

Submission to the
Victorian Law Reform Commission

Litigation Funding
And
Group Proceedings

Index

1. Introduction

The U.S. Chamber Institute for Legal Reform (**ILR**) is pleased to make this submission in response to the Victorian Law Reform Commission's (**Commission**) call for submissions in relation to the reference it received from the Attorney-General on 16 December 2016 (**Reference**).

The Reference asks the Commission to consider a number of issues with a view to ensuring that litigants who utilise the services of a litigation funder or are participants in group proceedings are not exposed to unfair risks or disproportionate costs risks.

In broad terms, the Commission is asked to report on:

(a) Whether there is scope for the supervisory powers of Victorian courts or Victorian regulatory bodies to be increased in respect of proceedings funded by litigation funders, in particular:

  (i) whether clearer disclosure requirements should be imposed in respect of a number of matters;

  (ii) whether any limits should be placed on (or an approval process required in respect of) the success fees that can be charged by litigation funders; and

  (iii) whether certain disclosure obligations should be extended beyond class action proceedings.

(b) Whether removing the existing prohibition on law firms (solicitors) charging contingency fees (save in certain types of matters) would assist to mitigate the issues presented by the practice of litigation funding.

(c) Whether the provisions of Part 4A of the *Supreme Court Act 1986* (Vic) (**Supreme Court Act**) should be amended to further regulate group proceedings (class actions),[1] including the possibility of the introduction of:

  (i) a "*certification procedure*"; or

  (ii) specified criteria for the Court's approval of a settlement under section 33V of the Supreme Court Act.

The question asked of the Commission in relation to the possible removal of the existing prohibition on contingency fees is, with respect to the Attorney-General, framed in a way that risks avoiding the real issues. Simply asking whether allowing solicitors to charge contingency fees "*would assist to mitigate the issues presented by the practice of litigation funding*" is of limited utility in the absence of a proper consideration of the other consequences that would flow from allowing such a practice.

[1] The expression 'class action' is used in this submission to refer to group proceedings as that expression is used in the *Supreme Court Act 1986* (Vic) and other Australian legislation.

2. The U.S. Chamber Institute for Legal Reform

ILR welcomes the Commission's investigation into the issues of litigation funders and class actions, which are ripe for reform. Subject to what was said above, ILR also welcomes consideration of the issue of contingency fees.

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 2016 was approximately AUD$42.2 billion.[2] Australia's total investment in the United States in 2016 amounted to around AUD $617.4 billion and the United States investment in Australia was approximately AUD $860.9 billion. [3] The United States is Australia's third largest trading partner.[4]

United States foreign direct investment (**FDI**) into Australia accounts for approximately 24 percent of Australia's total FDI.[5] In 2016, the total FDI into Australia from the U.S. was approximately AUD$195 billion.[6] 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] Department of Foreign Affairs and Trade, *United States Fact Sheet*, June 2017 <http://dfat.gov.au/trade/resources/Documents/usa.pdf>.

[3] Department of Foreign Affairs and Trade, *United States Fact Sheet*, June 2017 <http://dfat.gov.au/trade/resources/Documents/usa.pdf>.

[4] Office of the United States Trade Representative, *Australia* (2016) <https://ustr.gov/countries-regions/southeast-asia-pacific/australia>; Gregory O'Brien, *Australia's trade figures* Parliament of Australia (2016) <http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BriefingBook45p/AustraliaTrade>.

[5] Foreign Investment Review Board, *Annual Report 2015-16*, Foreign Investment Review Board (2016), 10.

[6] Department of Foreign Affairs and Trade, *United States Fact Sheet*, June 2017 <http://dfat.gov.au/trade/resources/Documents/usa.pdf>.

3. Summary of conclusions and recommendations

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

(b) Specifically:

(i) the level of disclosure provided by litigation funders is generally inadequate and often fails to disclose critical information. A regime to ensure the provision of adequate disclosure should be imposed on all litigation funders;

(ii) conflicts of interest are a serious issue in relation to litigation funding. The very limited requirement that litigation funders put in place systems to 'manage' conflicts of interest is inadequate. At the very least a fiduciary duty should be imposed on litigation funders;

(iii) the remuneration charged by some litigation funders in terms of success fees and other charges is excessive. Controls should be imposed on litigation funders in terms of the total amount of remuneration[7] a funder can take from any judgment or settlement of funded proceedings; and

(iv) 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, including capital adequacy provisions.

(c) The obligations and controls imposed on litigation funders should apply to all funded proceedings, including class actions, traditional litigation and arbitration.

(d) The Australian litigation funding industry operates in a national market and should be regulated and subject to supervision at the national level. Any significant differences in regulation between jurisdictions will distort the market for Australian litigation services and lead to an increase in forum shopping. To that end, the Commission should recommend to the Victorian Government that it work through the Council of Australian Governments (**COAG**) to introduce a national oversight regime for litigation funders.

(e) The Commission should consider, as a model for such a national oversight regime, the proposal advanced by ILR in August 2014.

(f) The Commission should recommend that the *Civil Procedure Act 2010* (Vic) (**Civil Procedure Act**) be amended to ensure that litigation funders comply with their overarching obligations.

(g) In the event that a national oversight regime cannot be established, the Commission should recommend that the Uniform Legal Profession legislation be amended to establish a regulatory regime for litigation funders within that framework.

(h) While it is said that the removal of the prohibition on law firms (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.

[7] The term 'remuneration' is used to describe all sums received by the litigation funder including any costs, charges, success fees and taxes however described.

(i) Part 4A of the Supreme Court Act should be amended to further regulate group proceedings by:

(v) introducing a certification procedure;

(vi) amending section 33C(1)(b) to remove the word 'related' and only permit class members with 'same or similar' circumstances to be included in the class;

(vii) amending section 33C(1)(c) to require that resolution of common issues in class actions substantially advance the determination of all class members' claims;

(viii) providing for the appointment of a third party or contradictor during settlement negotiations and to appear as an independent representative at any approval hearing; and

(ix) introducing a monitoring system of the distribution of settlement or other funds.

(j) The proposed changes to the Supreme Court Act should, if at all possible, be made in conjunction with similar changes to the class actions regimes which operate in the Federal Court of Australia (**Federal Court**),[8] and in New South Wales,[9] Queensland,[10] Victoria[11] and, potentially, in Western Australia,[12] in order to maintain uniformity and minimise the risk of forum shopping.

[8] *Federal Court of Australia Act 1977* (Cth), Pt 4A; *Federal Court Rules 2011* (Cth), Ch 2, Pt 9, Div 9.3.

[9] *Civil Procedure Act 2005* (NSW), Pt 10; *Uniform Procedure Rules 2005* (NSW), Pt 58.

[10] *Civil Proceedings Act 2011* (Qld), Pt 13A.

[11] *Supreme Court Act 1986* (Vic), Pt 4.

[12] Law Reform Commission of Western Australia, *Representative Proceedings: Project 103 - Final Report,* Report 103 (October 2015) [1.28].

4. Previous inquiries

As the Commission is aware, this is not the first Australian inquiry that has considered litigation funding, class actions, and the possible introduction of contingency fees for lawyers.

The introduction of Australia's first class action regime followed the 1988 Australian Law Reform Commissions (**ALRC**) report on proposed group proceedings in the Federal Court, which proposed a draft Bill.[13] Part IVA of the *Federal Court of Australia Act 1977* (Cth) (**Federal Court Act**) was broadly based on the proposals in the ALRC report.

In 2000, the ALRC published a report on the procedural and ethical issues which arise in group proceedings, making recommendations to improve efficiency, transparency, and fairness without supporting the lift of the ban on lawyers charging contingency fees.[14]

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:

(a) litigation funders should be required to hold a licence which would ensure that they:

  (i) can satisfy any liabilities they incur;

  (ii) properly inform their clients of relevant obligations; and

  (iii) implement systems for managing conflicts of interest.

(b) the prohibition on lawyers charging contingency fees should be lifted, save in family and criminal law matters, and such fees should be calculated as a percentage cap on a sliding scale; and

(c) the relevant State and Federal court rules should be amended to ensure that the Court's discretionary power to award costs against non-parties, and obligations to disclose funding agreements, apply equally to lawyers charging a contingency fee and litigation funders.[15]

The Federal Government is yet to act on these recommendations some three years after the report was delivered. Consequently, this submission proceeds on the assumption that no action will be taken to implement the recommendations. Nevertheless, any changes which are recommended by the Commission must take into account the national nature of the legal profession, and the national market for litigation. Any changes made in Victoria will affect all other jurisdictions.

[13] Australian Law Reform Commission, *Grouped Proceedings in the Federal Court*, Report No 46 (1988), App A.

[14] Australian Law Reform Commission, *Managing Justice: A Review of the Federal Civil Justice System*, Report No 89 (2000) [7.87]–[7.128]; Recommendations 78–82.

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

The Reference seeks advice in relation to issues that were identified as problematic from the outset by both government and academic commentators. For example, a paper prepared for the Standing Committee of Attorneys-General in May 2006, well before the decision in *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd,*[16] effectively confirmed the legality of the litigation funding industry, identified the risks that are still being discussed today and canvassed the need for regulation.[17] Regrettably, no action was taken in response to that paper.

[16] (2006) 229 CLR 386.

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

5. Litigation Funding

5.1 Recent developments in litigation funding and their effect on the Reference

The evolution of litigation funding in Australia and the basic contractual arrangements between litigation funders and their clients have been well documented in both the Commission's Consultation Paper, *'Access to Justice - Litigation Funding and Group Proceedings*' (**Consultation Paper**)[18] and elsewhere.

Accordingly, this submission will review these aspects of the matter only briefly, save in relation to one issue, the increasing incidence of After the Event Insurance (**ATEI**) as a mechanism to manage the risk of an adverse costs order in the event that the funded proceedings are unsuccessful. ILR has addressed this issue in some detail as 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.

After the Event Insurance

A key aspect of Australian litigation funding agreements is the undertaking, on behalf the funder, to indemnify the funded client against any adverse costs order in the event that the proceedings are unsuccessful.

It has long been argued by the litigation funding industry[19] 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. However, more recently it appears that 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 that the premium for an ATEI policy is in the order of 20 - 40 percent of the of the total legal charges protected against, although it can be lower.[20] However, the premiums are 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.[21]

ILR has now become 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.[22] It appears that there may also be a link

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

[19] 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.

[20] 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 < 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>.

[21] 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).

[22] 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>.

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 effectively 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 funder and insurer and the ability of the insurer to meet its obligations under the policy.

It is unlikely that the courts will be willing to address these issues. We are only aware of two instances where the use of a deed of indemnity by a foreign insurer as security for costs has been approved in Victoria.[23] 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*."[24]

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. [25]

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.

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.[26] 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

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[23] 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.

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

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

[26] 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>.

taken into account if, and when, any assessment is made by a potential client or the Court when it assesses the reasonableness of the proposed fees and charges. If that information is not available, there can be no proper assessment.

The litigation funding industry continues to evolve and expand

Litigation funders are exploring new opportunities and expanding the services they offer. For example, corporations are turning to litigation funders to fund proceedings that they might otherwise be reluctant to pursue given the impact on cash flow and the risk of an adverse costs order. Litigation funding is now also available to fund arbitrations. These developments are addressed in the Consultation Paper.

Finally, there is increasing interest in litigation as an investment. For example, hedge funds and private equity houses are said to see litigation as an attractive 'alternative asset class' as returns are uncorrelated to the stock market or bond returns.[27]

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 the Reference must be considered in the context of class action, traditional litigation and arbitration.

Moreover, any reforms must take into account the fact that the current business models and processes for litigation funders are not static. Elsewhere in the world, funders are beginning to finance the entire litigation portfolios of law firms.[28] Litigation funders have also begun using crowdfunding in the United States, for capital, with funding arrangements that are increasingly complex and sophisticated.[29] New business models will raise different issues or variances of existing issues, for example conflicts of interest.

Does litigation funding increase access to justice?

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

First, litigation funders only fund those cases where they believe there is a high prospect of substantial return on its investment. They have no interest in funding claims that are marginal, prospective, or that can be resolved without significant financial return – for example applications for injunctive relief.[30]

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*."[31]

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[27] John Hyde, 'Funding bonanza as litigation investors commit £723m to UK', *The Law Society Gazette* (online), 6 February 2017 <www.lawgazette.co.uk/news/funding-bonanza-as-litigation-investors-commit-723m-to-uk/5059708.article>.

[28] 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/>.

[29] 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/>.

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

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

Second, while the Australian class action regime was established on the basis that it would operate as an opt-out system, this did not suit the litigation funding industry's business model. It was unwilling to allow so called 'free riders' or class members who had not entered into a funding agreement, to participate in the class actions where other members were funded. As a consequence, the courts have allowed so called 'opt in' class actions to emerge which restricts the class to those who have entered into a funding agreement.[32] This restriction plainly limits access to the litigation for all injured or damaged parties.

Has litigation funding increased the court's workload?

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.[33] 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 questionable claims, as well.

It is also recognises 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 5.4 of this submission provides a particularly egregious example of this practice, there are many others.

There is also empirical evidence to support the contention that litigation funding has led to an increase in litigation and court workloads.[34]

5.2 The case for proper regulation and supervision

Despite all that has been written about the litigation funding industry, it is currently not well understood by the government, academics or the general public in Australia, in part because writings have not been particularly well balanced, but principally because the industry remains opaque. 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 or not a case will be funded 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[35] 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 assets – 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 Australian Stock Exchange (**ASX**) little or nothing is known about litigation funders':

(i) source of funds;

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[32] See, *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275, which found that class membership can be defined by class members who have entered into litigation funding agreements with a litigation funder.

[33] 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.

[34] 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.

[35] 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>.

(ii) profitability;

(iii) the way in which they operate, in particular, their control over the litigation;

(iv) the way in which they deal with their clients; or

(v) their ability to satisfy their liabilities.

More information about the industry and the way it operates is required to ensure adequate transparency to allow stakeholders to make a proper assessment of its claims and what it is offering clients.

Further, until litigation funders and the industry are 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.

Litigation funders are essentially unregulated

In large, part the lack of transparency flows from the fact that the litigation funding industry is essentially unregulated. It 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 Civil Procedure Act and certain limited requirements imposed by the Australian Securities and Investment Commission (**ASIC**). However, while these obligations exist, they are of little practical effect.

Civil Procedure Act

In Victoria, litigation funders, like lawyers, are subject to the "*overarching purpose*" of the Civil Procedure Act, which is "*to facilitate the just, efficient, timely and cost-effective resolution of the real issues in dispute.*"[36] Variations on this obligation exist in other Australian jurisdictions, but are generally only imposed on parties to litigation and their lawyers.[37]

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.[38] 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.[39]

[36] *Civil Procedure Act 2010* (Vic) s 7(1).

[37] *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.

[38] *Civil Procedure Act 2010* (Vic) s 10(1)(d)(ii).

[39] Ibid, ss 16 - 26.

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.[40]

The Court has made it clear that compliance with the overarching obligations is mandatory rather than aspirational.[41] However, unlike the parties who must certify that they understand their obligations prior to commencing proceedings,[42] 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 only aware of a single instance 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 funding the proceedings, Melbourne City Investments, was not conducive to giving effect to the overarching purpose of the Civil Procedure Act.[43] 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 a proceedings for abuse of process, not on breaches of the overarching obligations by the litigation funder under the Civil Procedure Act.[44]

Given the development of the litigation funding industry in Australia, and the role litigation funders now take in relation to the conduct funded proceedings, the Supreme Court Act should be amended to ensure that litigation funders both comply with their overarching obligations and are held to account should they fail to do so. At the very least, they should be obliged to certify to the Court that they have complied with those obligations when funded proceedings are commenced.

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, but merely generically as 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 the ASX to comply with 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

[40] Ibid, s 8.

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

[42] *Civil Procedure Act 2010* (Vic) s 41(1).

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

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

[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].

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.

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**).[50] The ASIC Act provides protections for consumers against unfair contract terms,[51] unconscionable conduct,[52] and misleading and deceptive conduct,[53] as well as an implied warranty that any services will be rendered with due care and skill.[54]

However, while these provisions exist, it is arguable that some would rarely apply to a litigation funding agreement as some or all such contracts may not meet the definition of a "*consumer contract*".[55] Further, because there is very little oversight of litigation funders, and 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.

Legal Profession highly regulated

In contrast to the lack of regulation of litigation funders, the Australian legal profession is one of the most, if not the most, regulated profession in Australia.

Scope of regulation

In Victoria, 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, *Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015* (Vic) and *Legal Profession*

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[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.

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

[51] Ibid, ss 12BF–12BM.

[52] Ibid, ss 12CA–12CC.

[53] Ibid, ss 12DA, 12DB, 12DF.

[54] Ibid, s 12ED(1).

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

Uniform Legal Practice (Solicitors) Rules 2015 (Vic).[56] 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.[57]

There is extensive regulation specifying 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.[58]

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 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 their being litigation funders.

Oversight by regulators and court

In order to ensure that 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 which has 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.[59]

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.[60] 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.

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[56] 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).

[57] 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>.

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

[59] Victorian Legal Services Board, *Victorian Legal Services Board and Commissioner Annual Report* (2016) 56.

[60] 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.

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.[61] 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 judgements 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 if it occurs 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.

The issues and concerns with litigation funding

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

(a) the inadequate disclosure to clients, and potential clients, of the terms on which the litigation funder will be remunerated, 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 action, 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, in the event that it secures a costs order in its favour, but is unable to enforce it against the litigation funder because of the latter's capital inadequacies; and

(e) the cost to the community and defendants as litigation funders run matters which have a marginal benefit to plaintiffs for the funders' own benefit, thereby imposing unnecessary burdens on the courts.

5.3 Disclosure

As the Consultation Paper notes,[62] there are a number of issues that arise in relation to the need for disclosure by litigation funders. First, disclosure to the litigation funders 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

Litigation funding agreements are complex arrangements with outcomes that depend on a range of factors.

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

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

[62] Victorian Law Reform Commission, *Access to Justice - Litigation Funding and Group Proceedings,* Consultation Paper, (July 2017) 52 - 68.

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 readily 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.

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, are comprehensively addressed in the Consultation Paper.[63]

In the absence of a proper oversight regime for litigation funders, it falls to the courts to provide appropriate consumer protection and supervision of litigation funders. This is in sharp contrast to the position of an insurer. The Australian insurance industry is highly regulated and subject to close supervision by the Australian Prudential Regulation Authority. Insurers operating in Australia, including foreign insurers, are licensed and there is a comprehensive complaint mechanism.

Federal Court 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**).[64]

First, 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.[65]

[63] Ibid, 63 - 66.

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

[65] Ibid, [5.2] - [5.3].

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 are any material changes to the litigation funding charges.

Second, the Practice Note also requires disclosure of the litigation funding agreement on a confidential basis to the Court and the other parties.[66]

While the fact that the Federal Court has recognised the importance of disclosure and adopted 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 in the Victorian Supreme Court, to non-class action litigation nor to arbitrations.

Second, 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 …*"[67]

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 Commission in its Consultation Paper, 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;

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[66] Ibid, [6].

[67] Ibid, [5.4].

(d) any conflicts or potential conflicts of interest that may arise and the mechanism for dealing with such a conflict;

(e) an estimate of the amount which the funded client may recover in the proceedings;

(f) an estimate of the cost of the proceedings;

(g) an estimate of the remuneration that the litigation funder will receive; and

(h) 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.

In terms of disclosure to the courts, the litigation funder should 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 during the course of the proceedings should be provided to the court within 5 working days of the change being agreed or communicated to the client.

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

5.4 Conflicts of interest

The Consultation Paper has identified in some detail the conflicts of interest which will inevitably arise where a litigation funder is involved in litigation.[68]

From the litigation funder's perspective, the most obvious conflict is that between the interests of the litigation funder and its client(s).

Litigation funding is a commercial enterprise. Litigation funders exist to generate profits for their owners. 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 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.[69]

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 often 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

[68] Victorian Law Reform Commission, *Access to Justice - Litigation Funding and Group Proceedings,* Consultation Paper, (July 2017) 44 - 50.

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

funders owe no fiduciary duty to their clients. A critical reform is the imposition of a non-waivable fiduciary duty on the part of the funder to act in the best interests of the client.

Lawyers as litigation funders

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

The well-known plaintiffs' 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.[70] They share a registered office. In addition, all of Maurice Blackburn's principals are beneficiaries of the discretionary trust.[71] 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*".[72]

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

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.[73] This suggests that 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[74] involved Melbourne City Investments (**MCI**), 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. [75] 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. [76]

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*

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

[71] Ibid.

[72] 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>.

[73] 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>.

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

[75] 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>.

[76] Ibid.

> *the Court do not exist – and are not to be used – merely to enable income to be generated for solicitors."*[77]

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.

Attempts to address the issue of conflicts of interest

As the Commission observes in the Consultation paper, in exchange for relief from the need to hold an AFSL, litigation funders are required to maintain adequate conflict of interest practices. Failure to do so, and failure to follow certain procedures for managing conflicts, is an offence.

However, there is no effective oversight by ASIC of this requirement. Once again, ILR is unaware of it ever having been enforced.

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."*[78]

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

A solution

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 the ASIC Act and no effective oversight of such obligations that exist.

Given that litigation funders fund more than just class actions, the introduction of a Victorian class action practice note will only add to the patchwork.

A possible solution can be found in the question of whether a litigation funder owes a fiduciary duty to their client. Litigation funders will generally deny such a relationship exists. Many endeavour to exclude the possibility by contract.

The issue has recently been considered by Associate Professors Simone Degeling and Michael Legg of the University of New South Wales.[79] In their paper, Degeling and Legg argue that litigation funders do, in a range of circumstances, owe a fiduciary duty to their clients. They also suggest that such a duty cannot be avoided by contract.

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[77] *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].

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

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

In these circumstances, one option would be to impose a fiduciary duty on litigation funders by statute and provide an oversight mechanism. A possible model for such a solution is set out in section 6 below.

5.5 Limits on fees paid to litigation funders

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, is grossly excessive. Indeed, the Attorney-General referred to this issue in his media release announcing the referral of the Reference to the Commission.

The Attorney-General said:

> *"This review will consider how we can better protect Victorian consumers from unfair costs, while ensuring that law firms and litigation funders continue to support worthwhile claims."*
>
> *"It is incredibly frustrating when a person wins a case, only to walk away almost empty-handed because the money has been soaked up by unfair legal fees."*
>
> *"The days of some litigation funders charging such excessive fees need to come to an end."*[80]

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*[81] 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.

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.

Having said that, the urgency to address this issue has been emphasised by the emergence of the common fund order. 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.

The approach of the courts

[80] Attorney General, 'Making Civil Justice Fairer for Victorians' (Media Release, 16 January 2017) <http://www.premier.vic.gov.au/making-civil-justice-fairer-for-victorians/ >.

[81] (2006) 229 CLR 386 at [92] (Gummow, Hayne and Crennan JJ).

When the issue of limiting litigation funding fees has been considered by the courts in the context of class action proceedings, a number of different approaches have been adopted.

In *Money Max Int Pty Ltd v QBE Insurance Group Ltd* (**Money Max**),[82] the Federal Court supported the notion of setting a cap on 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.[83]

In *Blairgowrie Trading Ltd v Allco Finance Group Ltd (Rec and Mgr apptd) (In liq) (No 3),*[84] 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.[85] 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."*[86]

Finally, in *Stewart, in the matter of Newtronics Pty Ltd,*[87] the Federal Court noted that it was important to ensure, that the entity providing the funding was not given a benefit "*disproportionate to the risk*" undertaken or a "*grossly excessive profit*".[88]

The *ad hoc* approach, that requires a court to form a view on what might be appropriate in terms of the litigation funders' remuneration each time a settlement comes before it for approval, is not the answer. The settlement approval hearing is not the right time to consider these issues. By this time, the parties have agreed an outcome and no one has any interest in delaying or derailing the settlement. Furthermore, a judge is not 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.

A solution

This is a critical issue that was identified by the courts from the time litigation funding first emerged in Australia. It is the issue that motivated the Attorney-General to provide the Reference to the Commission.

There are a number of factors which could be taken into account in determining what is a fair return to the litigation funder.

First, consideration could be given to calculating the maximum remuneration a litigation funder could receive by reference to a reasonable return on their investment.

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

[83] Ibid, 209 [80], [82], [86], [91], [147].

[84] [2017] FCA 330 (31 March 2017).

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

[86] Ibid, [160].

[87] [2007] FCA 1375 (28 August 2007).

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

Litigation lending is a form of investment. Capital can be deployed in equities, the real estate market, government bonds or any other number of investments. As has already been observed in this submission, litigation lending is now seen as an 'alternative investment class' – albeit one which has delivered handsome returns.

Determining an appropriate return on the investment would not be difficult. It may well be less than the return that is currently being earnt, given the apparently low rate at which funded cases fail. This approach would also allow the regulator to ensure that the real risk to the lender was reflected in the rate of return as that is influenced by:

(a) the litigation lenders ability to assess the viability of a case before any capital is invested;

(b) its use of ATEI; and

(c) the potential for setting off loses.

Second, a sliding scale could be mandated which reflects the point at which the proceedings have reached and the expenses that have been incurred by the litigation lender to that time.

Third, there should be, as there is in the case of fees charged by lawyers, a requirement that the litigation funders remuneration be proportionate to the loss that has been suffered. Such a requirement will reduce the risk that litigation funders will be tempted to initiate and fund proceedings where the benefit to class members is minimal but there is a potential to generate significant fees.

Finally, limits should be imposed on the entitlement of a litigation funder to take a percentage of the total amount of 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 what, in the Australian context, is a very large sum. 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 is very low.

A proposal for the implementation of these options is set out in section 6.

5.6 Capital adequacy

As has been observed above, little is known about the internal operations of many 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 these issues, let alone a mechanism to guarantee a shortfall or failure on the part of a litigation funder to honour its obligations.

The problem is exacerbated by the entry of smaller entities 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.[89] In these cases, even the minimal protections provided by, for example, the prohibition on insolvent trading, are of little or no value.

[89] 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.

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.

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.[90]

Given that 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 regulation.

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 a 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.

A proposal for the implementation of these options is set out in section 6.

[90] *Insurance Act 1973* (Cth), s 12.

6. Implementing reform

Comprehensive national reform

The Australian litigation funding industry has created a national market and given rise to a series of issues that require a national solution. While state-based reform is a strong step in the right direction, it will not completely address the issues that have been identified in this submission.

If litigation funders, or the lawyers with whom they work, consider the Victorian regulatory regime hampers their business model, they have the option of simply commencing the proceedings in a different jurisdiction.

Accordingly, ILR's urges the Commission to advocate for a national solution for a national problem. That is, the Commission should recommend to the Victorian Government that it work with the other states and territories, through COAG, to persuade the Federal Government to introduce national regulation of the litigation funding industry.

In many respects, this is the 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.[91] That proposal addresses each of the concerns that have been identified in this paper, save for the imposition of caps or limits on the level of remuneration charged by litigation funders.

The proposal, which implements a national licencing regime for litigation funders, is set out on pages 28 - 31.

[91] 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>.

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 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:

(a) 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

(b) 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 instructing 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.

A regulatory system for Victoria

As has already been observed, the Australian litigation funding industry operates in a national market and has given rise to a series of issues that require a national solution.

That said, we recognise that the Commission, and this Reference, are restricted to the State of Victoria. While the Commission may wish to make recommendations that call upon the Victorian Government to work with the Federal and other state and territory governments to develop a national solution, that will take time. Indeed, as the history of the Uniform Legal Profession Law project has demonstrated, this process can take decades.

In these circumstances, the Commission should consider a regulatory reform model that could be implemented immediately in Victoria. Alternatively, if the Victorian Government utilised the Uniform Legal Profession legislation with the cooperation of the New South Wales Government, the model could be implemented in both Victoria and New South Wales, which would cover the vast majority of the Australian legal and dispute resolution markets.

While a state based, rather than national solution, is not the best solution, it has the advantage of being one which the Victorian Government can implement on its own and implement quickly.

This state based regulatory model reflects the evolution of the litigation funding industry and acknowledges the role litigation funders now play in the legal system.

When litigation funding first emerged in Australia it was essentially just that – a mechanism for financing litigation through the provision of financial support to a party to proceedings. Litigation funders offered their clients a financial services product.

Over time the litigation funding business model has evolved. Many, perhaps the overwhelming majority, of litigation funders now play a very active, if not dominate, role in the proceedings they fund.

Consider, for example, the funded class action model.[92] The litigation funder will often work with a law firm to identify a potential action, explore its viability and then promote the proposed action in the media before any proceedings have been commenced. Once the class members have been assembled, through a 'book build', the funder will play key role in developing the strategy and managing the proceedings – indeed, many litigation funders charge what is described as a 'project management fee' for this service.[93] If, or when, settlement negotiations commence, the litigation funder will play a key role in deciding whether or not the matter should be settled rather than pursued to judgment.[94]

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[92] The recently announced and 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 is a recent example. See, Michael Janda, *Commonwealth Bank faces 'very large' shareholder action on money laundering scandal*, ABC News (23 August 2017) < http://www.abc.net.au/news/2017-08-23/commonwealth-bank-faces-shareholder-class-action/8833860>.

[93] IMF Bentham, 'Combined Financial Services Guide & Product Disclosure Statement' (18 January 2010) < http://www.imf.com.au/docs/default-source/site-documents/imf_fsgpds.pdf>; Application of David Kerr [2017] NSWSC 358 (5 April 2017), [14].

[94] IMF Bentham for example describes its principal activities as being the "investigation, management and funding of litigation claims" including "strategic planning, monitoring and managing of litigation" and "assistance in facilitating settlements and maximising the value of each claim". See, IMF Bentham, *Our Services*(2017) <http://www.imf.com.au/about> ; Similarly, JustKapital explicitly states that if its board decides to proceed and a formal offer is made to fund the litigation, the company will closely manage the case, attending all relevant meetings and settlement negotiations. The company also "tracks the progress of the litigation closely, consistently reviewing profitability. JKL can cancel the funding agreement with notice at any time." See, JustKapital, *Investor Presentation* (March 2015) slide 17 <https://www.justkapital.com.au/wp-content/uploads/2015/11/Investor-Presentation-March-2015.pdf?target=blank>.

These developments are reflected in the increasing numbers of lawyers, often very experienced dispute resolution practitioners, who are staffing the litigation funders.[95]

The role of the litigation funder in providing the instructions in the matter – albeit as a shadow litigant and quasi dispute resolution practitioner – is all the more obvious when some funders concede that it is actually in the best interests of the proceedings (and thus their business model) to select a 'vulnerable' member of the community to fill the role of the representative plaintiff, for the purpose of making the most sympathetic possible presentation to the Court.

Litigation funders are often playing a role in the conduct of proceedings that is no less significant, in terms of its impact on the conduct of those proceedings, as the plaintiff's solicitor. At the same time, the remuneration that litigation funders are charging their clients grossly exceeds anything that could be charged by a lawyer. The conflicts of interest as between litigation funder and client, let alone funded client(s) and other class members, inherent in the litigation funding model, are potentially more serious than as between lawyer and client – something which is exacerbated by the absence of the fiduciary duties owed by lawyers to their clients.

The level of involvement and control of litigation funders in the management and conduct of court and arbitration proceedings, has reached the point where litigation funders should be regulated as participants in the legal system. In one sense, this has already been acknowledged by the inclusion of litigation funders amongst those who are subject to the overarching purpose and obligations provisions in the Civil Procedure Act. However, as has already been noted, this may well be more illusory than effective.

The rationale for the imposition of such a system of regulation is that litigation funders play a direct role in how litigation is conducted, which is akin to the role played by lawyers. The actions and decisions of litigation funders have a direct – and often deleterious effect – on the rights of litigants and class members, such that they should be subject to regulatory oversight.

Moreover, courts are not involved in scrutinising the conduct of litigation funders in every case. Indeed, they only do so in class actions. In single-plaintiff funded actions, the relationship between litigation funder and litigant remains unscrutinised because there is no role for the Court to approve any settlement. There is absolutely no court involvement, and thus no scrutiny or control, in funded arbitrations. Even where an arbitral award is subject to subsequent judicial scrutiny, that is not a scrutiny of the dealings between the litigation funder and the applicant in the arbitration.

The Victorian Parliament has already recognised that litigation funders fall into a category that is similar to a lawyer, as it has legislated to apply the overarching purpose and overarching obligations in the Civil Procedure Act to litigation funders. This policy decision should be given real effect by subjecting litigation funders to lawyer-like regulation.

Obviously, litigation funders are not lawyers. The regulatory regime applicable to lawyers should not apply to them *mutatis mutandis.* But there are elements of the Legal Profession Uniform Law system which could be applied to litigation funders.

Specifically, the Legal Profession Uniform Law should be amended to provide for the regulation of litigation funders so as to require the following:

(a) Litigation funders should be registered as a litigation funder (**Victorian Funding Entity**) by the local regulator if they wish to provide litigation funding services in connection with any litigation or arbitral proceedings in Victoria (**Funding Services**). This should include provision for the registration of foreign corporations or other entities providing Funding Services in Victoria.

[95] See, for example, the IMF Bentham website which reveals that the members of its 'team', while described as 'Investment Managers', are all qualified, with a significant number of them very experienced barristers and solicitors with extensive commercial litigation backgrounds. See, IMF Bentham, *Meet the IMF Bentham Team* (2017) <http://www.imf.com.au/about/meet-the-team>.

(b) Registration as a Victorian Funding Entity should be conditional upon the regulator being satisfied that the litigation funder is a fit and proper person, or, if the funder is a body corporate, that its directors and managers are fit and proper persons to be directors and managers of a litigation funder.[96]

(c) Any person who is employed or retained by a Victorian Funding Entity to manage or direct any aspect of funded litigation or arbitration should be required to hold a practicing certificate.

(d) The legislation should make provision for Victorian Funding Entities to:

(i) provide a prescribed minimum level of disclosure;

(ii) enter into written funding agreements with clients;

(iii) implement and maintain procedures for the avoidance and management of conflicts of interest;

(iv) not charge more than is reasonable in the circumstances;

(v) provide an indemnity against any adverse costs order as part of any funding package; and

(vi) satisfy the fiduciary and other ethical obligations imposed on Australian legal practitioners engaged in litigation.

(e) A Victorian Funding Entity should be obliged to act in the best interests of their clients (the litigant party or the class members).

The proposition is not novel. Non-lawyers involved in the legal system are subject to regulation. For example, law clerks and secretaries are deemed to be associates of a law practice, and are therefore subject to legal professional regulation.[97] Likewise, conveyancers who are not lawyers are required to be licenced.[98] As part of the conveyancers' licensing regime, they are required to hold professional indemnity insurance,[99] disclose their costs to their clients,[100] avoid conflicts of interest,[101] deal with trust money in a similar way to solicitors,[102] and are subject to having their practices taken over and managed by a statutory manager appointed by the Director of Consumer Affairs.[103]

Regulatory oversight and enforcement would be provided through the existing Office of Legal Services Commissioner. This is a Victorian Government agency that is completely independent of the Law Institute of Victoria and the Victorian Bar Association, the two professional organisations that represent lawyers in Victoria.

The implementation of this proposal would ensure that clients of litigation funders receive the same level of protection when they engage the services of a litigation funder, as they would in

[96] Similarly to the position under the *Narcotic Drugs Act 1967* (Cth), s 8B.

[97] *Legal Profession Uniform Law Application Act 2014* (Vic) sch 1, s 6(1).

[98] *Conveyancers Act 2006* (Vic), s 8.

[99] Ibid, Pt 3.

[100] Ibid, s 47.

[101] Ibid, s 49.

[102] Ibid, Pt 5.

[103] Ibid, s 96.

relation to legal practitioner. It would also provide the courts with confidence in relation to the conduct of those funding proceedings that come before the Court.

Determining a level of remuneration that is fair to both clients and litigation funders

This Reference has its origins in the very real concerns that the remuneration charged by some litigation funders is excessive.

Consumers who are seeking the assistance of litigation funders to fund litigation have limited options for funding, little or often no real opportunity to negotiate the terms on which funding is offered,[104] and often only a limited understanding of what they have given up in terms of the return they will receive from the proceedings.

The courts have recognised this issue from the very beginning of litigation funding in Australia. As has been noted earlier in this submission,[105] Australian courts have repeatedly expressed concern as to the 'fairness' of the remuneration charged by litigation funders. More recently, the courts have displayed a willingness to intervene to protect the clients of litigation funders in the course of class action settlement approval hearings.[106]

While ILR welcomes these developments, they are of only limited effect. First, the court's intervention has to date been restricted to funded class actions. Second, there are no comprehensive or consistent criteria that have been identified against which a court should measure or consider the fairness of the proposed remuneration. Third, there is a real question as to whether it is appropriate to require a trial judge to make these assessments, particularly in the context of settlement hearing.[107]

What is required is both a set of criteria against which the fairness of the proposed remuneration is assessed and a mechanism for dealing with cases where the consumer believes the remuneration being taken by the funder is excessive.

In ILR's submission, this issue is best addressed by way of legislation identifying the criteria to be taken into account in determining whether the remuneration being charged by the litigation funder is a fair in all the circumstances. In making that assessment, 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 return on its investment (**ROI**). This could include a cap on the 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. This could include provision for a minimum percentage to be received by the plaintiff after these deductions; and

(d) an assessment of the risk taken by the litigation funder in funding the proceedings.

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[104] The AML/CTF class action against the Commonwealth Bank of Australia to be funded by IMF Bentham is typical of the approach taken by the funder. Potential clients are invited to 'register their interest' on the company's website and then subsequently sent an information pack which includes an invitation to sign and return by email a funding agreement and retainer agreement pursuant to which they both enter into a comprehensive funding agreement and retain a lawyer to act on their behalf without any face to face interaction whatsoever, let alone explanation of or negotiation in relation to the terms of either agreement. See, IMF Bentham, *CBA Shareholder Class Action*, (21 August 2017) <http://www.imf.com.au/cases/register/cba-shareholder-class-action-overview>.

[105] See, above n 81.

[106] See above n 83.

[107] See above section 5.5 .

While this may be seen as a difficult issue 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. This 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, for example by way of an ATEI policy. It will be important to ensure that this is not seen as an invitation to reward speculative or other actions with little prospect of success driven by the prospect of a windfall gain should the defendant be obliged to settle to dispose of 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.

7. Should there be further regulation or changes to class action procedure under Part 4A of the Supreme Court Act?

There have been significant developments in the class action industry in the years since Part 4A of the Supreme Court Act was enacted.

While the Part 4A regime has proved to be reasonably flexible in managing these developments, there is merit in considering some changes so as to ensure that the class action regime continues to provide appropriate access to justice, and that the Court's resources are utilised efficiently.

Certification

Perhaps the most contentious question in terms of Australian class action procedure is the issue of whether or not a certification process should be utilised.

The ALRC originally recommended that the Australian class action system not adopt a certification procedure. The ALRC made this recommendation because the U.S. class certification process was seen as time consuming and expensive, with the preliminary certification proceedings often being more complex than the hearing of the substantive issues. The ALRC's view was that a certification procedure involving broad discretion would be wasteful and could discourage the use of the class action procedure.[108]

However, in accepting the ALRC recommendation, Australia adopted a class action system that is pretty well unique. As the Consultation Paper observes, Australia is one of the few jurisdictions in the world that does not utilise some form of class action certification procedure.[109]

The best known certification procedure is found in *U.S. Federal Rules of Civil Procedure* which provides that, when a person sues or is sued as a representative of a class, the Court must, at an early practicable time, determine by order whether to certify the action as a class action.[110]

Plaintiffs wishing to proceed by way of a class action in the U.S. must demonstrate that:

(a) the class is so numerous that joinder of all members is impracticable;

(b) there are questions of law or fact common to the class;

(c) the claims or defences of the representative parties are typical of the claims or defences of the class; and

(d) the representative parties will fairly and adequately protect the interests of the class.

The plaintiff must also satisfy the Court that, *inter alia*, "*the questions of law or fact common to class members predominate over any questions affecting only individual members*."[111] As a consequence, courts are reluctant to allow claims that involve unique issues of causation for each class member, such as pharmaceutical or medical device, to proceed as class actions.[112]

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[108] Australian Law Reform Commission, *Grouped Proceedings in the Federal Court*, Report No 46 (1988), 63 [146] - [147].This is supported by Christopher Withers, 'Commonality requirements in US class actions' (2011) Summer *Bar News: Journal of the NSW Bar Association* 48.

[109] Victorian Law Reform Commission, *Access to Justice - Litigation Funding and Group Proceedings,* Consultation Paper, (July 2017) 73 -75.

[110] *Federal Rules of Civil Procedure* (eff. Dec. 1, 2016), r 23(a)(2).

[111] Ibid, r 23(b)(3).

[112] Stuart Clark and Christina Harris, 'Class Actions in Australia: (Still) A Work in Progress' (2008) 31 *Australian Bar Review* 63, 68.

Where there are competing class actions, the Court may, as part of the certification process, both nominate the class action that is to continue and determine which of the plaintiffs' lawyers should be allowed to conduct the proceedings. When choosing between competing groups of lawyers, the Court will consider factors such as estimated legal costs and experience in running class actions.[113]

As there is no certification requirement in Australia, a representative plaintiff does not need to demonstrate to the Court that any preliminary criteria have been met or that the case is an appropriate one to proceed as a class action. Rather, once the threshold requirements are met,[114] the onus is on the defendant to challenge whether the proceedings should continue as a class action or by some other means.[115]

The thresholds for commencing a class action in Australia are easily satisfied in practice. As a consequence, it is easy to commence a class action without having first properly considered:

(a) whether the case is an appropriate one to be pursued by way of a class action; or

(b) how the case will proceed using the class action mechanism.

The ease with which class actions can be commenced in Australia, generates a number of challenges in the absence of some form of initial 'certification' by the Court.

For example:

(a) class definitions – are often vague and imprecise;

(b) unsuitable class actions – actions which are brought for, and on behalf of, a wide and disparate group of individuals, where no thought is given as to how the case will actually proceed or how any findings made in the proceedings in relation to the representative plaintiff can be utilised in resolving the claims of the other group members. In truth, everyone simply hopes that, once the representative plaintiff 's claim has been determined, a so called 'global settlement' will be negotiated. While this usually happens, it is often at the cost of the other group members taking a significant discount on the damages they receive; and

(c) competing class actions – in some instances competing class actions are permitted to proceed with group members represented by multiple law firms, who may pursue similar, but strategically different, cases and which are subject to multiple litigation funding arrangements. Competing class actions involve considerable cost to the courts and the broader community and waste both time and resources. They also confuse potential class members.[116]

[113] *Re Lucent Technologies Securities Litigation* 221 FSupp2d 472 (DNJ, 2001), a securities fraud class action; see also *Re Auction Houses Antitrust Litigation* 197 FRD 71 (SDNY, 2000); *Re Amino Acid Lysine Antitrust Litigation* 918 FSupp 1190 (NDIll, 1996); *Re Wells Fargo Securities Litigation* 156 FRD 223 (NDCal, 1994); *Re Oracle Securities Litigation* 131 FRD 688 (NDCal, 1990) cited in *Kirby v Centro Properties Ltd* (2008) 253 ALR 65, 73 [34].

[114] *Supreme Court Act 1986* (Vic) s 33C(1).

[115] Ibid, ss 33M, 33N(1).

[116] Professor Morabito has found that approximately 15 per cent of all class actions filed in Australia since the introduction of the Federal Court class action scheme have been competing class actions. Since the introduction of Victoria's class action regime in 2000, 38 per cent of the instances of competing class actions were filed in more than one jurisdiction: 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, 56.

While these problems have been recognised and acknowledged by many commentators,[117] any proposal to introduce a certification procedure in Australia has been vehemently opposed by plaintiffs' lawyers.[118]

In the absence of a certification procedure, defendants and the courts have been obliged to deal with the problems that have been identified by way of interlocutory applications. This, in turn, has been criticised by plaintiffs' lawyers who describe such applications as "*[t]actics of delay and attrition.*"[119]

In the final analysis, this is really just a question of timing – either the challenges which plague class actions in Australia can be dealt with (or mainly be dealt with) at the commencement of the case, or they can be dealt with as the matter progresses.

In our submission, there is merit and efficiency in seeking to resolve any issues at the commencement of the class action through a certification procedure.

Threshold issues

Any certification procedure would be enhanced if the threshold requirements for commencing a class action under section 33 of the Supreme Court Act where modified by amending:

(a) 33C(1)(b) to remove the word 'related' and only permit class members with 'same or similar' circumstances to be included in the class;[120] and

(b) section 33C(1)(c) to require that resolution of common issues in class actions substantially advance the determination of all class members' claims. This would require the class action to have the potential to make a meaningful contribution to advancing the resolution of class members' claims.[121]

These amendments would ensure that the class action regime (as well as the Court's resources) are used to provide efficient access to justice.

Adequate representation

Finally, further amendments should also be considered in respect of section 33D of the Supreme Court Act, to require the representative plaintiff to demonstrate that they are able to adequately represent the class members.

While the Court has the power to replace a representative plaintiff who is inadequate,[122] such an order can only be made at the request of class members. Under this option, while adequacy of representation would not be a threshold requirement for the commencement of a

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[117] Victorian Law Reform Commission, *Access to Justice - Litigation Funding and Group Proceedings,* Consultation Paper, (July 2017) 75.

[118] In response to King & Wood Mallesons suggestion of a U.S.-Style class certification stage, Maurice Blackburn's principal, Jacob Varghese, said "*At this stage I think it's unnecessary. If a larger firm brings up a class action it's probably not going to be struck out*". See, Peter Godfrey, *Plaintiff firm returns fire in class action stoush*, Australasian Lawyer (4 April 2014) <https://www.australasianlawyer.com.au/news/plaintiff-firm-returns-fire-in-class-action-stoush-186118.aspx> ; see also, Samuel Issacharoff and Thad Eagles, 'The Australian Alternative: A View from Abroad' *UNSW Law Journal*, 38(1) (2015) 179, 191.

[119] Bernard Murphey and Camille Cameron, 'Access to Justice and the Evolution of Class Action Litigation in Australia' (2006) 30(2) *Melbourne University Law Review* 399.

[120] John Emmerig and Michael Legg, 'Twenty Five Years of Australian Class Actions—Time for Reform' (2017) 36 *Civil Justice Quarterly* 164,166.

[121] Ibid, 167.

[122] *Supreme Court Act 1986* (Vic), s 33T.

class action, it would require the representative plaintiff to affirmatively establish adequacy of representation as part of proceedings.[123]

Establish clear criteria for settlement approval hearings

As at 1 June 2017, some 65 percent of all class actions commenced in Victoria since the introduction of part 4A of the Supreme Court Act, have settled.[124] The settlement of a class action under the Supreme Court Act must be approved by the Court.[125]

As a consequence of the opt-out class action regime, class members who are not actually before the Court and who do not 'opt out', are bound by any settlement and cannot litigate the same issue at a later stage. Class members, other than the representative plaintiff and those with identical interests to the representative plaintiff, will not necessarily have their interests considered by the Court at any settlement approval hearing.[126]

The protection of the 'absent' class members falls to the Court which must 'approve' the settlement after assessing whether the settlement is fair and reasonable. The legislation is silent as to the factors that the Court must take into account. While some guidance is provided in the Supreme Court of Victoria Practice Note for Class Actions (**Supreme Court Practice Note**),[127] and the overarching obligations contained in the Civil Procedure Act,[128] this is far from comprehensive.

The Court's role in protecting unrepresented class members during settlement is made more difficult by the non-adversarial nature of the settlement approval hearing. By the time that the Court's approval is sought, the representative plaintiff and defendant have negotiated and agreed the terms of the settlement.[129] Nobody is interested in 'rocking the boat'.

It is submitted that the appointment of a third party, or contradictor during settlement negotiations and to appear as an independent representative of the 'absent' class members, would more adequately protect class members, as it would allow for the adversarial contest of competing rights to be heard.[130]

Monitor distribution of settlement or other funds.

In conjunction with establishing clear criteria for settlement approval hearings under section 33V of the Supreme Court Act, there should be a greater supervisory role for the Court in monitoring the distribution of settlement funds.

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[123] John Emmerig and Michael Legg, 'Twenty Five Years of Australian Class Actions—Time for Reform' (2017) 36 *Civil Justice Quarterly* 164,168.

[124] Data provided by Vince Morabito, 2 June 2017.

[125] *Supreme Court Act 1986* (Vic), s 33V.

[126] Michael Legg, 'Class action settlements in Australia - the need for greater scrutiny' (2014) 38 *Melbourne University Law Review* 590, 594.

[127] Supreme Court of Victoria, *Practice Note SC Gen 10—Conduct of Group Proceedings (Class Actions)*, 30 January 2017.

[128] *Civil Procedure Act 2010* (Vic) ss 16 - 26.

[129] See generally, Ray Finkelstein, 'Class Actions: The Good, The Bad, and The Ugly' 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) 415; Michael Legg, 'Judge's Role in Settlement of Representative Proceedings: Lessons from United States Class Actions' (2004) 78 *Australian Law Journal* 58; Michael Legg, 'Class Action Settlements in Australia—The Need for Greater Scrutiny' (2014) 38 *Melbourne University Law Review* 590.

[130] Michael Legg,'Class Action Settlements in Australia - The Need for Greater Scrutiny' (2014) 38(2) *Melbourne University Law Review* 590, 608-613; see *King v AG Australia Holdings Ltd* [2003] FCA 1420 (5 December 2003); *Dorajay Pty Ltd v Aristocrat Leisure Limited* (2008) 67 ACSR 569.

As class action promoters and litigation funders are not officers of the Court, they are largely free of court scrutiny in relation to the contractual arrangements, including fee disbursements.[131] Class actions pose a potential risk to class members as there are unique conflicts of interest that arise as between lawyers and the funder; that is, between class members and both funder /lawyer and between class members.[132]

A recent example of these problems can be seen in the settlement of the Murrindindi–Marysville fire class action and the distribution of the settlement funds among the 5,800 class members.[133]

Possible reform options to ensure fairness in the distribution of settlement funds may include the introduction of ASIC oversight. [134] As Anna Harley argues, regulations and oversight by the Court and ASIC will contribute to a more stable environment in which the litigation funding market can continue to grow.[135]

Need to ensure consistency is maintained across jurisdictions

Although these submissions are being made in the context of the Reference and focus on Victorian legislation, it is critical that any proposed reform options are ultimately considered for implementation at a national level.

As the Chair of the Commission acknowledged, this Reference is the first examination of the litigation funding industry by a state agency and, as he observed, the Commission "*will certainly take into account the question of consistency*" as "*we would of course want consistency of national regulation.*"[136] Justice Cummins expressed the hope that the Reference sparks similar inquiries in other jurisdictions as "*[i]t is clearly an area that should be looked at and it is clearly an area where there should be harmony across the jurisdictions*."[137]

Without nation-wide reform of the class action procedure, the practice of "*forum shopping*" is likely to arise.

This must be avoided. Accordingly, it is submitted that any reform and increased regulation of class action procedure, should ultimately be implemented on a national level and not just in Victoria, as consistency in this industry is paramount.

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[131] Anna Harley, 'Class action settlement in Australia: A regulatory work in progress?' (2014) 3 *Journal of Civil Litigation and Practice* 68, 69; see also, Michael Legg, 'Entrepreneurs and Figureheads – Addressing Multiple Class Actions and Conflicts of Interest' (2009) 32(3) *University of New South Wales Law Journal* 909, 924.

[132] Ibid.

[133] Pia Akerman, 'Bushfire Victims Demand Inquiry into Legal Firm', *The Australian* (Sydney) 22 May 2017; *Rowe v Ausnet Electricity Services Pty Ltd* [2015] VSC 232 (27 May 2015).

[134] Anna Harley, 'Class action settlement in Australia: A regulatory work in progress?' (2014) 3 *Journal of Civil Litigation and Practice* 68.

[135] Ibid, 77.

[136] Chris Merritt, 'Litigation inquiry could set the standard', *The Australian* (online), 24 March 2017 < http://www.theaustralian.com.au/business/legal-affairs/litigation-inquiry-could-set-the-standard/news-story/89a3204cb7d92148fd037637648235e8>.

[137] Ibid.

8. Contingency fees

As the Commission notes, lawyers in Australia have long been prohibited from charging contingency fees.[138] The prohibition arose from the common law crime and tort of maintenance and champerty. Even though both common law offences were abolished in Victoria many years ago,[139] the ban on contingency fees has been, and remains, articulated in legislation.[140] 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.[141]

There is a general view in the Australian community that allowing lawyers to enter into contingency fee agreements would not be in the public interest. There is a very real concern 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 ALRC, in its report into the introduction of class actions in Australia, noted that one of the key protections against the emergence of United States style litigation was the fact that Australian lawyers where prohibited from entering into contingency fee agreements with their clients.[142]

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

In truth, virtually the only voices calling for the introduction of contingency fee agreements are plaintiffs' lawyers.[143]

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

While not addressed in the Consultation Paper, 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.[144] From the litigation funder's perspective, it further reduces the actual risk it is facing.[145]

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[138] Victorian Law Reform Commission, *Access to Justice - Litigation Funding and Group Proceedings*, Consultation Paper, (July 2017), 16 [2.31] - [2.33].

[139] *Abolition of Obsolete Offences Act 1969* (Vic) ss 2, 4.

[140] *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).

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

[142] Australian Law Reform Commission, *Managing Justice: A Review of the Federal Civil Justice System*, Report No 89 (2000), 312, 315, 540-541.

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

[144] 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 >.

This will inevitably further erode the return actually received by the plaintiff from the proceedings.

In the event that any consideration where to be given to allowing lawyers to enter into contingency fee agreements that 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 fees 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.[146]

It has been argued that the resultant increase in competition would place downward pressure on the remuneration charged by litigation funders.[147] 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, is that:

> "*At the other end of the spectrum, [contingency fee agreements] <u>may</u> create some competition for litigation funders … .*" [148]
> (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 as they are simply too small.[149] 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.

Given that 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, conducting the matter on a contingency fee basis, take

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[145] 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> .

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

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

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

[149] 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>.

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 actually charge less than a litigation funder. Indeed, given that they may well be taking on smaller, more risky, claims there may well charge more.

The changes that have been implemented in the United Kingdom are instructive. In the United Kingdom, caps apply on the contingency fees that can be charged by a lawyer. The caps are set at 25 percent for personal injury cases, 35 percent for employment cases, and 50 percent for all other cases.[150] 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 that litigation funders charge around 30 per cent of the total amount recovered,[151] this suggests that there will be limited competition on fees.

Fourth, it has never been suggested that a lawyer offering to act on a contingency fee basis would be willing to indemnify their client against an adverse costs order as do litigation lenders. This is a significant disincentive to taking a contingency fee agreement offer from a lawyer as compared to a traditional litigation funding agreement.

Accordingly, a plaintiff in these circumstances would have to being willing 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 was a corporation, it may face the prospect of an application for security for costs. None of these alternatives will be particularly attractive for many potential plaintiffs.

Absent a real increase in competition driven by both a real choice for consumers between the two similar products and 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.[152] 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.

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

[151] 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].

[152] 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 >.

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*."[153] No doubt, the availability of contingency fees with the potential to receive a 'success fee' over and above the lawyer's normal fee would create an incentive for the lawyer to self-fund a matter. However, 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.

In any event, for access to justice to be meaningful, for a potential client requires a lawyer who actually has the capacity and capability to effectively represent them, not just the financial motivation to take on the case. As has been observed by by the UK Legal Services Board, the biggest market failure in law is that there is no affordable supply of legal services.[154] However, as the President of the Law Institute of Victoria has conceded, simply lifting the ban on contingency fees, although likely to increase competition in the market, will not necessarily increase access to justice. Rather, as he suggested, multiple responses should be considered to increase access to justice, including for example contingency loans (which operate in a similar way to HECS or HELP loans), legal expense insurance, and unbundled legal services (parts of the matter completed by a lawyer and others by the client).[155]

One of the more audacious arguments that have been advanced in support of the introduction of contingency fees is the suggestion that this would allow plaintiffs firms to run more 'social justice' litigation.[156] 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 and there is 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 now view the contingency system as a mechanism for high, relatively easy returns.*"[157]

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 that the result will be the emergence of more competing class actions with the potential for overlapping classes of members.

This would give rise to a mirage of increased competition, whilst in reality simply, increasing costs, increasing the amount of litigation and placing pressure on Australia's already overburdened legal system.

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

[154] Stephen Sapountsis, 'Future Litigation Funding Approaches' (Speech delivered at the Future of Civil Procedure: Innovation & Inertia Forum, Australian Centre for Justice Innovation, Monash University, 17 February 2016). <https://www.liv.asn.au/Staying-Informed/Speeches/Speeches/February-2016/Speech--Future-litigation-funding-approaches>.

[155] Ibid.

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

[157] 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.

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 overall amount 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.[158] 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 – 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.[159]

In the case of 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 actual merit of the claims at issue, 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.[160]

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.[161]

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.

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[158] 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>.

[159] 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.

[160] 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>.

[161] 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.

Conflict of interest

In the Australian legal system, the lawyer/client relationship has long been recognised as a fiduciary relationship. The term 'fiduciary' means trust, so 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.

A key element of the lawyer's fiduciary duty to the client is the duty not to put his or her interest before those of the client. Put another way, the essence of fiduciary obligations is that the fiduciary is precluded from acting in any other way 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'.[162]

The duty of a fiduciary is "*to avoid and not merely "manage" a conflict of interest or prioritise one interest over another.*"[163]

Lord Cranworth LC formulated that rule in *Aberdeen Railway Co v Blaikie Brothers*[164] 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:[165]

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

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[162] *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 46–47.

[163] 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> .

[164] (1854) 1 Macq 461, 471.

[165] 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> .

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 an a significant award of damages, albeit at some risk of the case failing. A settlement offer may be received which, while well short of what might be awarded in a final judgement, provides a certain return on the lawyer's investment.

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*". [166]

Therefore, an American commentator suggests contingency fees "*destroys the attorney-client relationship.*"[167]

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 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 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",*[168] 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,[169] to understand why such a position is unacceptable.

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[166] 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.

[167] Ibid.

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

[169] Ibid.

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 for this to be so.

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; and

(b) the lawyer either indemnifies the client against any adverse costs order or otherwise ensures that the funded client is able to meet any adverse costs order.

That is not to say that the lawyer must indemnify the funded client against such an order. Rather, the obligation should be framed in a way that requires the lawyer to ensure that the funded client has the capacity to meet such an order, by way of, for example, substantial assets, a bank guarantee or an ATEI policy. Any obligation for the lawyer to personally indemnify would only come into effect if the steps the lawyer was obliged to take in this regard failed.

29 September 2017