Appendix I

Third Party Litigation Financing in Australia – Class Actions, Conflicts and Controversy
http://www.instituteforlegalreform.com/uploads/sites/1/TPLF_in_Australia_page_web.pdf

U.S. CHAMBER
Institute for Legal Reform

Third Party Litigation Financing in Australia

Class Actions, Conflicts and Controversy

OCTOBER 2013

U.S. CHAMBER
Institute for Legal Reform

An Affiliate of the U.S. Chamber of Commerce

© U.S. Chamber Institute for Legal Reform, October 2013. All rights reserved.

This publication, or part thereof, may not be reproduced in any form without the written permission of the U.S. Chamber Institute for Legal Reform. Forward requests for permission to reprint to: Reprint Permission Office, U.S. Chamber Institute for Legal Reform, 1615 H Street, N.W., Washington, D.C. 20062-2000 (202.463.5724).

Table of Contents

Executive Summary 1

Introduction 3

Access to Justice: Limitations of Litigation Funding 7

Litigation Increase: Funding Increases the Scale of Class Actions 12

Conflicts of Interest: Inherent in Third Party Litigation Financing 15

Open Class Actions: Prejudice to Non-Funded Group Members 19

Conclusion 30

Prepared for the U.S. Chamber Institute for Legal Reform by

Moira Saville, Peta Stevenson and Caroline Rodgers, King & Wood Mallesons

The authors thank Hugh Atkin, Tom O'Brien, Hannah Bellwood and Matt Sherman for their assistance in preparing this report.

Executive Summary

Third party litigation financing is relatively young in Australia, and the industry has been largely unregulated. Litigation funders often claim that they provide increased access to justice in an attempt to justify both the role they play, and the limited oversight in the area. However, in reality, litigation funders choose cases solely to maximise their profits, which means that only a narrow category of cases are funded, and funded class actions are being tailored to suit the needs of large institutional class members. The lack of oversight of the industry is not justified by the limited, and often overstated, role played by litigation funders in providing increased access to justice.

Recent outcomes in class actions suggest that oversight is required to deal with a number of challenges that third party litigation financing presents to the administration of justice in Australia, including:

- **Increased Litigation:** Empirically, third party litigation financing increases the scale and complexity of litigation, and has the potential to increase the number of unmeritorious claims instituted.
- **Conflicts of Interest:** Third party litigation financing heightens the risk that lawyers will be restrained from acting in the best interest of their clients, as litigation funders are free to contract for almost exclusive control of the litigation, and the long term nature of the relationships between litigation funders and law firms discourages lawyers from making decisions adverse to the interests of litigation funders (even when those decisions are in the best interests of clients).
- **Prejudice to non-funded group members:** There is a danger that the commercial incentives introduced by third party litigation financing lead to settlements which are structured to favour the interests of litigation funders and/or group members who have entered into funding agreements, to the prejudice of group members who have not entered funding agreements.

Any regulation of third party litigation financing needs to consider these issues, and other controversies surrounding litigation funding outlined in this paper.

"With the business model that [litigation funder] IMF has, which is perfectly legitimate ... all that has little to do with access to justice."

— Justice Sackville, August 2012[1]

Former Judge of the Federal Court of Australia and Acting Judge of the Court of Appeal of the Supreme Court of New South Wales

Introduction

Litigation funding schemes were described by the previous Australian Federal Government as schemes involving a person or entity that is not a party to litigation, and has no direct interest in its outcome, paying the costs in return for a percentage share of the proceeds if the litigation is successful.[2] More colloquially, third party litigation financing (TPLF) has been described as *"financiers bankroll[ing] court cases for a percentage of any damages."*[3]

In Australia, third party litigation funders or investors (Funders) primarily fund large scale litigation, including corporate insolvencies, commercial and contractual disputes and securities and consumer protection claims.[4] The continuing prevalence of TPLF in Australia has promoted the use of representative or group proceedings—'class actions'—as a means of pursuing claims, and the involvement of Funders in class action proceedings has added multiple layers of complexity to the issuing, running and resolving of such disputes.

Against this backdrop, this paper explores some of the controversies surrounding TPLF as it occurs in Australia, using examples drawn from recent litigation, to demonstrate the value of increased regulatory oversight of the industry.

Major Players in the Australian TPLF Market

Presently, the Australian TPLF market includes a number of Australian and off-shore Funders:[5] see Figure 1: Current Funders in the Australian Market, below. The absence of regulatory barriers to entry into the Australian funding market, and the potential profits to be made by Funders, have recently encouraged a number of new Funders to commence operations in Australia. The involvement of more Funders will inevitably drive more class action litigation as they compete for market share.

In a typical TPLF arrangement, the Funder will contract with one or more potential litigants. The Funder pays the litigation costs (such as lawyers' fees and disbursements) and usually indemnifies the funded litigant from the risk of paying the other party's costs if a claim fails. If the claim succeeds, the Funder receives a percentage of any settlement or judgment, usually after its costs have been reimbursed.[6] IMF (Australia) Ltd (IMF), Australia's largest Funder, indicates that its commission from compensation awarded to class action group members normally ranges between 20% and 45%.[7] IMF listed on the Australian Stock Exchange (ASX) in 2000 and was the only

Funder in Australia to hold an Australian financial services licence (AFSL) until it applied to have its licence cancelled in April 2013.[8] Hillcrest Litigation Services Ltd (also ASX listed) suggests that a Funder typically receives 30% to 45% of the amount ultimately recovered under a funded claim[9] and LCM Litigation Fund Pty Ltd suggests that its commission is between 35% and 50%.[10] Those returns have not reduced despite new entrants to the market. Despite the high investment returns on offer to Funders and the significant impact they have on the administration of justice within Australia, the Australian TPLF industry remains largely unregulated.

Figure 1, below, lists the major players in the Australian TPLF industry. Three things are apparent from this table. First, most Funders operating in Australia are privately held, and do not make their financial information publicly available. Second, several of the largest Funders operating in the country are incorporated outside of Australia. Third, most Funders on the list are reported to be funding class action litigation.

Figure 1: Current Funders in the Australian Market

Funder	Listed?	Incorporated in Australia?	Reported to be funding class action(s)?	Public accounts or financial information?
IMF (Australia) Limited (ACN 067 298 088)	✔	✔	✔	✔
Hillcrest Litigation Services Limited (ACN 060 094 742)	✔	✔	✖	✔
LCM Litigation Fund Pty Limited (ACN 078 747 092)	✖	✔	✔	✖
Litigation Lending Services Limited (ACN 129 188 825)	✖	✔	✔	✔
Quantum Funding Pty Limited (ACN 129 864 713)	✖	✔	✖	✖
Claims Funding Australia Pty Limited (ACN 158 551 967)	✖	✔	✔	✖
Comprehensive Legal Funding LLC (ARBN 132 369 003)	✖	✖ USA	✔	✖
International Litigation Funding Partners Pte Limited	✖	✖ Singapore	✔	✖
Omni Bridgeway	✖	✖ The Netherlands	✔	✖
Argentum Investment Management Limited	✖[1]	✖ UK	✔	✖

1 The Argentum Group is made up of three companies: Argentum Capital Limited, Argentum Investment Management Limited and Argentum Litigation Services Limited. Argentum Capital Limited is listed on the Channel Islands Stock Exchange: Argentum Group website, available at http://www.aglitigation.com/about-us/overview/.

Class Actions, Conflicts and Controversy

A number of current issues relating to TPLF support arguments in favour of increased regulatory over-sight of the TPLF industry in Australia, with several emerging issues also creating concern. This paper addresses each of these issues in the following sections:

- **Access to Justice:** The notion that TPLF promotes access to justice has long underpinned arguments in TPLF's favour and has been cited as the justification for no regulation at all, or at most, a minimalist approach to its regulation. However, an analysis of the methods employed by Funders in determining what types of claims to pursue and how to pursue them suggests that the extent to which TPLF provides access to justice has been considerably overstated by its proponents. Accordingly, any such claims ought to be closely scrutinised in formulating a proportionate regulatory approach.

- **Increasing Litigation:** The availability of TPLF increases the scale and complexity of litigation and carries with it the risk that unmeritorious claims will be funded in the hope of achieving a settlement. This section considers statistical data on the impact of TPLF on the court system and practical examples of this impact.

- **Conflicts of Interest:** Lawyers must have undivided loyalty to their clients. This fundamental fiduciary obligation governs the lawyer/client relationship. However, the nature of TPLF increases the risk that a lawyer's loyalty will be divided between the client and the Funder. To date, these risks have not been subject to effective oversight.

- **Prejudice to non-funded group members:** A practice of employing equalisation factors in class action settlements has developed, effectively reallocating the burden of a Funder's premium so that it is shared by all group members irrespective of whether they decided to enter into a funding agreement. Little notice of proposed equalisation factors has been given to group members and their fairness has not been adequately considered. This section considers some of the issues to which equalisation factors give rise, including whether non-funded group members are adequately represented in the settlement of funded class actions; whether scrutiny should be given to the reasonableness of premiums; the potential for conflicts of interest between funded and non-funded group members; and the potential for abuse of class action settlements by Funders to extract a return beyond that to which they are contractually entitled.

The paper concludes by briefly highlighting various other issues relating to TPLF that are as yet unresolved, but certainly should factor into any analysis of an appropriate oversight regime for TPLF, including what happens if a Funder collapses or walks away during the course of a class action; how the problem of competing class actions will be addressed; and whether Funders owe (or should owe) duties to funded and/or non-funded group members.

> *"Carried out prudently and in full consultation with stakeholders, it is likely that regulatory reform will prove beneficial to the industry. It will provide certainty for funders, their clients and lawyers; improve the responsible provision of litigation funding in Australia; and enhance its providers' prospects."*

Access To Justice: Limitations of Litigation Funding

The notion that TPLF promotes access to justice has long underpinned discussions about regulatory settings in the funding industry. When the former government exempted Funders from the Australian financial services licencing regime, access to justice was advanced as the justification for this approach.[12] However, in recent years a number of eminent commentators have questioned the extent to which TPLF delivers on this promise.[13] Indeed, last year Justice Sackville observed:

> [T]he business model that IMF has, which is perfectly legitimate … has little to do with access to justice … The Government justified the lack of regulation on funders because it improves access to justice, but access to justice is not really advanced when you have a business model that says 'we will only provide assistance for those cases that are going to win.'[14]

The commercial incentives driving the business model of IMF and other Funders are such that both the type of claims they select and the manner in which those claims are pursued provide limited access to justice for those who would otherwise not be able to afford it while nevertheless having a significant impact on the conduct of litigation within Australia.

Funders Target Very Specific Types of Claims

Funders have been open about the highly selective nature of their support for legal proceedings. Of the 763 cases considered by IMF between February 1999 and June 2007, 90 were selected for funding, 18 of which were group proceedings.[15] Based on the funding criteria published by Funders and the cases that they have pursued in the courts, it is clear that they have tended to pursue high value, low risk claims in a narrow range of areas.[16]

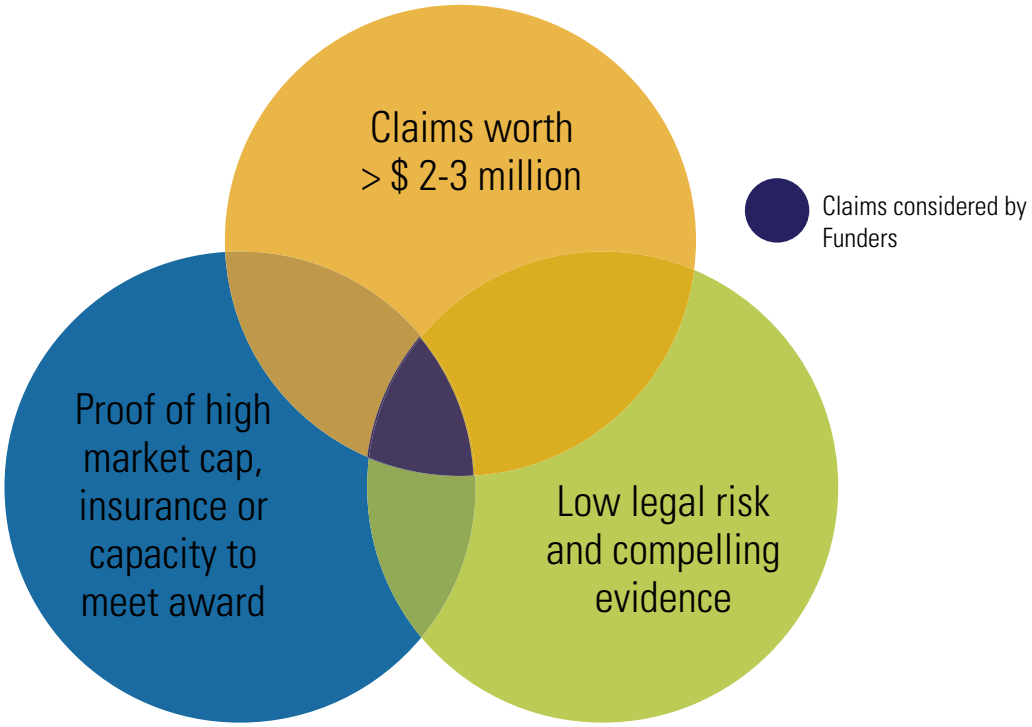
FINANCIAL THRESHOLDS ARE HIGH

Funders must be satisfied that the claims they choose to support will generate an adequate return on investment. As a consequence, claims must meet high value thresholds in order to be considered for funding, and claims that seek injunctions, declarations or other non-monetary relief are automatically excluded.[17] Claims must also satisfy cost versus return thresholds. IMF has indicated that it only considers claims with a value greater than $2 million,[18] and other major Funders also adopt claim thresholds in the $2-3 million range.[19] Funders additionally require proof that a prospective defendant will be able to meet a damages award. In the context of securities class actions, IMF has indicated that the prospective defendant must have a market capitalisation of at least $100 million or sufficient insurance before it will consider pursuing an action.[20] These financial thresholds mean that only a very specific class of claim is considered for TPLF. TPLF provides no additional access to justice for claimants seeking non-monetary relief or in circumstances where aggregate claim thresholds are not met or where the prospective defendant does not meet Funders' criteria.

QUALITATIVE CRITERIA FAVOUR A NARROW RANGE OF ACTIONS

If a claim is likely to be sufficiently valuable, Funders apply a range of qualitative criteria in order to determine the probability of a settlement or award. The application of these criteria has tended to further narrow the class of claims considered.

Figure 2: Claims Considered by Funders



IMF states that it will not consider claims which are likely to be dependent upon oral evidence, actions which will involve a factually-rich forensic inquiry or actions where proof of causation is likely to be problematic.[21] It has a stated preference for claims where it considers there is evidence that the conduct of the defendant is "*reprehensible,*"[22] and it is reluctant to take on cases which are likely to involve multiple defendants.[23]

The claims which are most likely to meet these criteria are those involving alleged breaches of market protection legislation, e.g., breaches of disclosure obligations, misleading or deceptive conduct, product liability or competition legislation.[24]

Within this range of actions, product liability claims and cartel claims pose further difficulties which render them unlikely to be funded. Funders have tended to regard product liability claims as risky because they often lack a sufficient degree of commonality between group members and frequently involve detailed factual evidence and additional claims against other non-party defendants.[25] Cartel actions are often considered unsuitable because of evidentiary difficulties arising from the secretive nature of cartels and a lack of regulatory co-operation, dispersal of class members and problems with loss quantification.[26]

As a result of applying these factors, Funders have displayed a strong bias towards funding large-scale securities class actions. Because of the complexity of securities actions, as well as the large sums involved, these cases have consumed significant court resources. Of the 18 funded class actions brought in the Federal Court up to 2009, 11 related to securities, one was a cartel proceeding and the remaining six concerned disparate issues.[27] Since 2010, at least a further nine funded securities class actions have been issued. In securities class actions, institutional investors with substantial claims generally constitute the bulk of group member claims by value. Institutional investors do not constitute a class of claimant which could not afford access to justice absent TPLF. The class action mechanism has been employed by institutional investors in a manner which allows recovery of claimed losses, while protecting institutional investors from both the scrutiny of their individual claims and the risk of adverse costs orders which they would bear if they were party to proceedings. While smaller investors have also participated in securities class actions, as discussed below, funded securities class actions are increasingly being run in a manner which favours institutional investors and which erodes or eradicates any access to justice benefits for those with smaller claims.

Limited Participation in the Fruits of Class Actions

In order to generate a return on their investment, Funders must be confident that a substantial proportion of class members will contribute to their fees and uplifts.[28] This desire to maximise return on investment, and an associated concern with preventing 'free riders' from sharing in the fruits of funded litigation, have led to two trends which further limit access to justice: the rise of closed classes and a focus on actions involving larger class members such as institutional investors and sophisticated

corporate customers. Closed class proceedings can usefully address significant problems caused by opt-out proceedings such as quantification of claims and class member consent. They are discussed here because they run counter to the rationale that funding increases access to justice.

FUNDERS PREFER CLOSED CLASSES

Funders have a strong incentive to ensure that as many group members as possible share the costs of class action proceedings. Broader participation in funding agreements increases the economic viability of actions and Funders' returns. It is undermined where class members are able to free ride by participating in the fruits of a class action without contributing to its costs.

In recent times, Funders have sought to prevent free riding by adopting closed classes. In a closed class case, the representative applicant defines the class to include only those who have entered into funding agreements with the Funder.[29] Closed class proceedings can be contrasted with open class proceedings in which all persons coming within the class definition are able to make claims to receive money from a fund which is established after settlement or judgment to distribute damages or settlement funds, irrespective of whether they have entered into a funding agreement. After some initial uncertainty,[30] the closed class mechanism has been found to be permissible by the courts.[31] Closed classes were adopted in 13 of the 18 funded class actions pursued in the Federal Court between 1992 and 2009.[32]

One side-effect of the employment of closed classes is the commencement of copycat class actions. Because a closed class, by its nature, is generally limited to those who have entered into a funding agreement, there may be a sizeable rump of claimants who have not entered into a funding agreement but who otherwise meet the class definition of the initial action. In those circumstances, there is a substantial risk that a second action (whether open or closed) will be commenced soon after by a second law firm (with or without funding) seeking to piggyback off the first action. The *Centro*,[33] *Nufarm*[34] and *Oz Minerals*[35] class actions all saw the commencement of mirror proceedings of this kind. This phenomenon can result in substantial duplication of legal costs and has the potential to substantially undermine the goals of efficiency and certainty underlying the class action regime in Australia.

The extent to which access to justice is facilitated by closed classes appears limited, as the members of such classes often reflect a relatively small number of claimants (usually institutional investors) with relatively large claims. For example, in the *Multiplex* class action,[36] the closed class of around 100 members comprised a large number of institutional investors whose claims formed 99% of the claims in terms of dollar value.[37] In the *Centro* proceeding, the closed class represented by Maurice Blackburn contained 1,349 group members, while the open class represented by Slater & Gordon was estimated to contain in excess of 5,000 group members who were mostly *"mums and dads and other small investors."*[38] The relative size of the claims in the respective classes was borne out by the distribution of the settlement sums with $150 million (before legal costs and the Funder's return) of the $200 million settlement sum allocated to the closed class.

CLASS ACTIONS ARE INCREASINGLY TAILORED TO INTERESTS OF LARGER, MORE SOPHISTICATED CLIENTS

Another trend in recent times has been the exclusion of smaller, 'mum and dad' claimants from class actions. Actions consisting of large numbers of smaller claimants (where access to justice concerns are presumably most acute), are often considered uneconomical to pursue and the incentives to pursue claims involving group members who have large claims such as institutional investors and corporate customers (where access to justice concerns are least acute) are far greater. Indeed, senior management of IMF has candidly admitted that IMF may disqualify cases that are *"made up of too many small claims."*[39] Funders have also been known to seek exclusion of smaller claimants who come within a broader group definition.[40] For example, in the *Air Cargo* class action,[41] the group definition is confined to those who purchased services costing $20,000 or more. These trends are particularly concerning given that a key policy argument for funded group proceedings is that they allow smaller claimants, who would otherwise lack the financial resources or incentive to bring a claim, to participate in proceedings and vindicate their rights.

In a similar vein, settlement agreements in recent class actions disclose a trend towards differential funding contributions based on the economic power of the class member, with institutional class members negotiating preferential funding arrangements with Funders. For example, in a recent funded shareholder class action, the settlement agreement provided for higher funder contributions from those with a smaller number of shares and lower contributions from those with large parcels.[42] While it might be argued that administration expenses justify the differential charges, larger institutional investors could be expected to take a more active interest in the conduct of a case and are likely to possess far greater bargaining power vis-à-vis the Funder than a small investor. There is a real danger that such differential arrangements effectively amount to the cross-subsidisation of institutional investors' claims by smaller 'mum and dad' investors. This is antithetical to the original goals of the class action system, which is intended to protect and promote the interests of small claimants.

A 'hands off' approach to the regulation of TPLF has traditionally been justified on access to justice grounds. However, recent trends in case selection, class closure and class composition suggest that the additional access provided by TPLF is limited.

"Recent trends in case selection, class closure and class composition suggest that the additional access provided by TPLF is limited."

Litigation Increase: Funding Increases the Scale of Class Actions

The availability of TPLF increases the scale and complexity of litigation and carries with it the risk that unmeritorious claims will be funded in the hope of achieving a quick settlement.

Statistical Evidence Suggests That Funding Increases Litigation

A recent report by David Abrams and Daniel Chen suggests that TPLF increases the scale and complexity of litigation.[43] This finding is consistent with the following features of TPLF.

FIRST, FUNDERS CONSISTENTLY CLAIM THAT THEY INCREASE ACCESS TO JUSTICE

An increase in litigation is a necessary corollary of acceptance of this claim. As discussed above, there is good reason to doubt the extent to which Funders do provide access to justice. However, to the extent that such access is provided by Funders, this necessarily entails generating more litigation. By reason of the large potential profits available to Funders and to plaintiff law firms, it is in their respective commercial interests to seek to foment litigation. In its 2013 Annual Report, Slater & Gordon, a publicly listed Australian law firm, openly states that one of its priorities for the current financial year is "*re-building the pipeline of funded class action matters*."[44]

SECOND, THE VERY PRESENCE OF FUNDERS INCREASES THE COMPLEXITY OF LITIGATION

Once Funders are involved in litigation the following complexities often occur:

- **Access to Funding Agreements:** it has been common for interlocutory disputes to arise in relation to defendants' access to the funding agreement;[45]
- **Security for Costs:** applications for security for costs are more readily made when a Funder is involved;[46]
- **Judicial Oversight of Funding:** the propriety of the involvement of the Funder may itself require judicial consideration, such as whether the specific funding arrangements are an abuse of process[47] or create irreconcilable conflicts[48] for the solicitors on the record; and
- **Settlement Process:** the presence of Funders necessarily complicates the court's approval of settlement of class actions.

THIRD, THE CONTINGENT NATURE OF FUNDERS' FEES CREATES AN INCENTIVE FOR THE FUNDER TO MAKE CLASS ACTIONS AS LARGE AS POSSIBLE

Obviously, large class actions take up more court time, potentially raise complex issues such as finding suitable representative claimants to represent all of the class and relating to causation and are inherently more difficult to case manage.

FOURTH, THE QUANTUM OF SETTLEMENT FIGURES OF RECENT SECURITIES CLASS ACTIONS HAS BEEN INCREASING

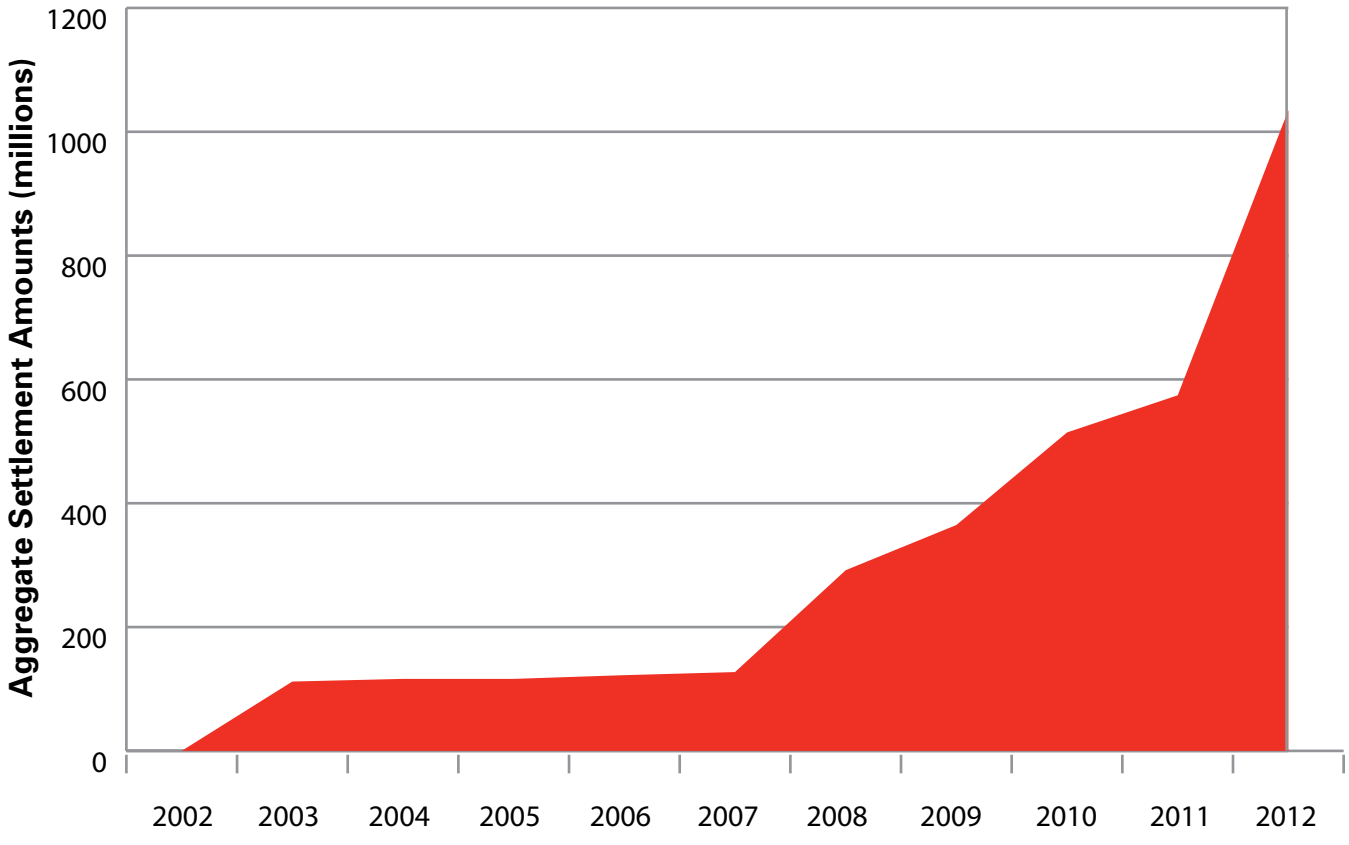
As shown in Figure 3 below, the scale of class actions is increasing with the majority of such actions being funded. This indicates that TPLF is increasing the scale of class actions.

It should not be assumed that the below figures represent the true value received by group member claimants. Significant portions of those settlement figures would have been directed towards legal costs and returns to Funders. For example, of the $200 million for which the *Centro* class action settled,[50] $62 million went to IMF and an unknown amount to the other Funder, Comprehensive Legal Funding LLC (CLF),[51] and a total of $32 million in legal fees was approved by the Court.

FIFTH, THERE IS NOTHING PREVENTING TWO OR MORE FUNDERS FUNDING COMPETING CLASS ACTIONS IN RESPECT OF THE SAME GRIEVANCE

This was the case in the *Centro* class action where IMF funded two actions, with Maurice Blackburn acting, and CLF

Figure 3: Significant securities class action settlements[49]



funded a third action against Centro, with Slater & Gordon acting. Other examples of competing funded class actions include proceedings relating to:

- **Oz Minerals:**[52] The two class actions, which involved Maurice Blackburn funded by IMF, and Slater & Gordon funded by Litigation Lending Services Limited (LLS), saw a total of just under $5 million in legal fees awarded, with Funder IMF reporting a net gain of $12.8 million from its investment in the proceedings[53] and more than $2.8 million being paid to LLS.[54]

- **Nufarm:**[55] Two class actions were commenced in relation to continuous disclosure allegations, with Maurice Blackburn funded by International Litigation Funding Partners Pte Ltd (ILFP) and Slater & Gordon funded by CLF. The two proceedings were consolidated in mid-2011 on the basis of joint representation, and a settlement of $46.6 million (inclusive of costs and Funders' fees) was approved in November 2012.

Such parallel funding of parallel class actions creates unnecessary duplication of costs, and adds a further level of complexity to the proceedings in general and in particular to attempts to settle such proceedings.

Funding May Encourage Unmeritorious Claims

The Supreme Court of New Zealand recently commented that TPLF *"could exacerbate the risk of defendants being faced with unmeritorious claims and forced into unjustified settlements."*[56] This echoes the sentiments expressed in 2009 by Justice Keane. His Honour noted that the case of *Emmanuel & Ors v Fosters*[57] was *"an exemplar of the concern that litigation funding does promote the pursuit of frivolous litigation."*[58] In that case, Justice Chesterman indicated that *"there was a degree of irresponsibility in the plaintiffs' bringing and prosecuting their actions,"* found that the proceedings were vexatious and ordered indemnity costs against the plaintiffs.[59]

This may be so because Funders are looking for a sufficient scale of claim which works for their business models. In relation to class actions, Funders are not necessarily concerned with scrutinising the merits of individual claims, and unmeritorious claims, which might not succeed if pursued individually, can be hidden within a large class.

Conflicts of Interest: Inherent in Third Party Litigation Financing

At the core of the relationship between lawyers and clients is lawyers' duty of undivided loyalty to their client: they must avoid conflicts between their personal interest and the interests of their client and thus must never gain unauthorised profit from their position. However, the nature of TPLF increases the risk that a lawyer's loyalty will be divided between the client and the Funder. To date, these risks have not been subject to effective oversight, despite the introduction of the Australian Securities and Investments Commission's (ASIC) conflict of interest regime in July 2013.

Structural Risks

Both the contractual arrangements involved in TPLF and the long-term nature of the relationships between Funders and particular law firms heighten the risks of conflicts of interest arising for lawyers between the interests of Funders and the interests of their clients. This heightened risk is caused by at least three factors, commonly present in funded litigation.

FIRST, FUNDERS OFTEN ENJOY A LARGE DEGREE OF CONTROL OVER LITIGATION THEY CHOOSE TO FUND

As the New South Wales Law Reform Commission explained:

> To ensure the success of the litigation, the funder takes control of major decision making. This may include retaining and giving instructions to the solicitor who acts for the plaintiff, prohibiting that solicitor from directly liaising with the plaintiff, and reserving the right to settle the claim.[60]

In *Campbells Cash & Carry v Fostif*,[61] where the High Court held that TPLF was not an abuse of process, the Funder had almost complete control over the conduct of the litigation, save that it required 75% approval from the represented claimants before it could agree to a settlement. The solicitors were forbidden from contacting the claimants directly. Such an arrangement

clearly undermines the lawyer/client relationship, for it can hardly be said that such a lawyer has undivided loyalty to the clients when the lawyer is unable to contact them or to take instructions from them.[62] Where the Funder's interests conflict with those of the clients, the instructions given to the lawyers will clearly be in line with the Funder's interests.

That is not to say that Funders always enjoy this level of control in proceedings they fund.[63] However, without adequate regulation, Funders are free to contract for such control, which heightens the risk that instructions given to lawyers will be in conflict with the interests of clients.

SECOND, IT IS COMMON FOR FUNDERS AND PLAINTIFF LAW FIRMS TO DEVELOP CONTINUING RELATIONSHIPS, WHICH POTENTIALLY TEST LAWYERS' UNDIVIDED LOYALTY TO THEIR CLIENTS

Many of those clients are only with the firm for the life of the action, whereas the relationship between the firm and the Funders spans over multiple actions and carries with it the promise of future collaboration and remuneration, as Funders often influence the selection of lawyers for claims they fund.[64] For example, it appears that the majority of class actions underway in the Federal Court since 2011 in which Maurice Blackburn has acted have been funded by IMF.[65]

There is a risk that the value of such a relationship to a law firm may (unconsciously) influence choices made by lawyers during proceedings, including when the interests of Funders and claimants collide. As Justice Keane said in relation to the High Court's decision to allow litigation funding:

> I suppose we should be celebrating the good news that the pessimistic view of human nature which, for several hundred years, has informed the common law's disapproval of champerty is no longer correct. Lawyers used to be greedy, but now we're better. And to the extent that we lawyers might still be susceptible to distraction from our duty by our own pecuniary interests, it is comforting to be reminded that the courts can prevent abuse of their processes. But, in my respectful opinion, these sanguine expectations are not justified by experience.[66]

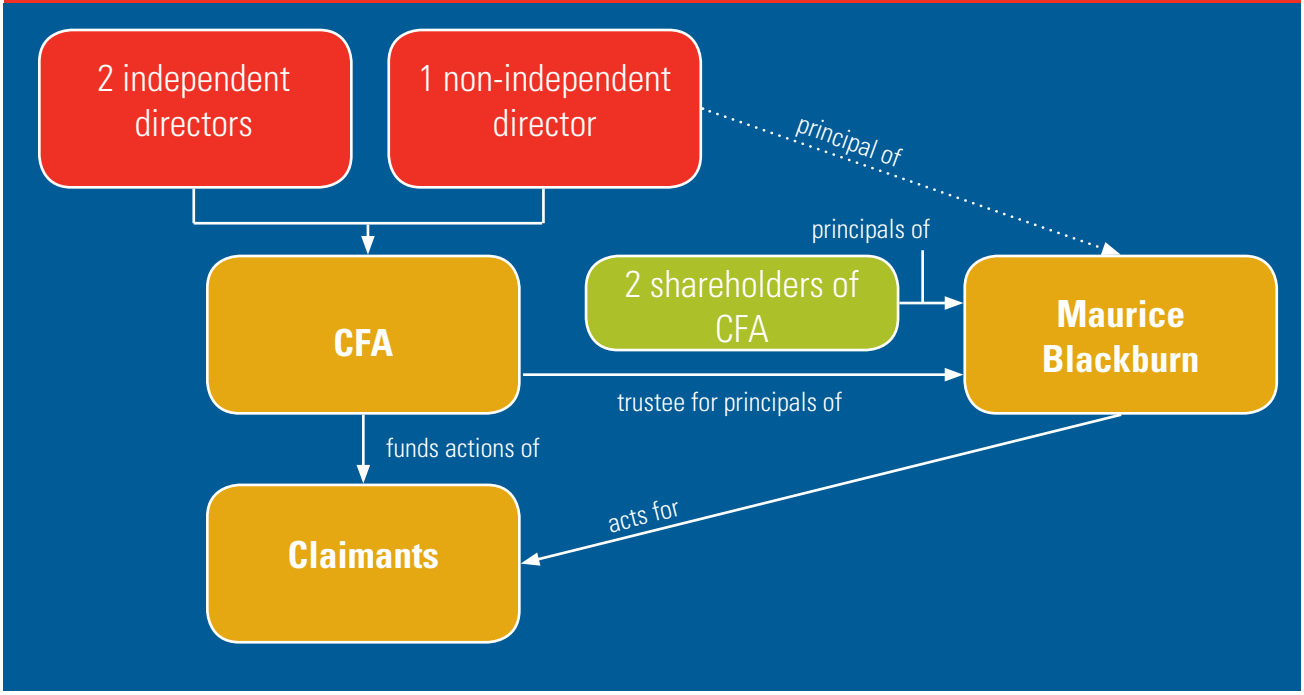
THIRD, ONCE A CLASS OF CLAIMANTS HAS BEEN AMASSED, IT IS COMMON FOR FUNDERS AND LAWYERS TO CHOOSE THE REPRESENTATIVE PLAINTIFF

The representative plantiff, unless prohibited from doing so by agreement with the Funder will instruct the lawyers. This enables Funders and lawyers to choose a compliant representative plaintiff who will not provide instructions that will conflict with the interests of the Funder, even when such instructions are not in the best interests of the representative plaintiff or the class as a whole.

A Worrying Development

One plaintiff law firm, Maurice Blackburn, has established its own Funder, Claims Funding Australia Pty Ltd (CFA), which funds actions in which a principal of Maurice Blackburn is the solicitor on the record. The relationship between CFA and Maurice Blackburn, as it currently stands, is demonstrated in Figure 4.[67]

Figure 4: Ownership / Control Structure of CFA



This type of arrangement potentially:

- increases the risk of conflicts of interest between lawyers, Funders and claimants; and
- undermines the independence of lawyers from the Funder and the claimants.

The risks associated with conflicts of interest are heightened by the arrangement, such as the one outlined above, as the interests of the principals of the law firm and the Funder are more directly aligned. This is so because any profit made by the Funder is (despite the interpolation of a trust structure) effectively made on behalf of the principals of the law firm. If a conflict of interest arises between the claimants and the Funder, the principals of the law firm have a greater pecuniary incentive to side with the Funder, given the Funder is acting in the principals' financial interest. This arrangement exacerbates the issues Justice Keane identified that: *"[T]he vindication of victims' rights is the last thing on the mind of the funders and the lawyers whose interests they serve."*[68]

> *"[T]he vindication of victims' rights is the last thing on the mind of the funders and the lawyers whose interests they serve."*

It is hard to see how a lawyer's loyalty to their client could be said to be 'undivided' where such an arrangement exists. This is not to say that principals of such firms will act improperly, only that the pecuniary alignment of the interests of Funders and lawyers increases the risk that they might do so.

Before signing a funding agreement with CFA, claimants are required to sign a declaration that they have considered obtaining independent legal advice in relation to the arrangement.[69] This requirement suggests a tacit acknowledgement of the problems the arrangement may create for claimants, such as conflicts of interest. Further, the requirement for claimants to pay for independent legal advice is difficult to reconcile with the Funders' purported role in providing access to justice for those who could not otherwise afford it.

The arrangement also has the potential to undermine the independence of principals of the law firm from both the Funder and the claimants. In *Waterford v the Commonwealth*,[70] Justice Brennan opined that a necessary component of being a legal adviser is a degree of independence from one's client. It could be said that such arrangements undermine the independence of law firms, as its principals would have 'too much skin in the game.'

Regulation Fails To Adequately Address the Heightened Risk of Conflict

From 12 July 2013, litigation funding arrangements have been governed by the *Corporations Amendment Regulation 2012 (No. 6)* (Cth), as explained by ASIC's Regulatory Guide 248. This Regulation requires Funders to have written procedures including in relation to:

- identifying and evaluating potential conflicts of interest;
- disclosing conflicts of interests to members; and
- managing conflicts of interest in relation to settlement offers.

These regulations are a step in the right direction to manage the risks outlined above. However, no direct consequences flow from a failure to comply with the regulations. As ASIC's Regulatory Guide makes clear, breach of the regulation will only be met with exposure to greater risk of regulatory action.[71] Such regulatory action may include a Funder having to acquire an Australian financial services licence and comply with the provisions of the *Corporations Act 2001* which regulate managed investment schemes. The vague threat of such regulatory actions is insufficient to ensure that the heightened risks associated with TPLF are addressed. For the regulations to be effective, they require teeth.

Open Class Actions: Prejudice to Non-Funded Group Members

The past five years have seen a number of funded open class actions in which the representative applicant and some, but not all, group members enter into a funding agreement with a Funder (the funded group members) while the remaining group members do not enter into such an agreement and also do not opt out of the class action (the non-funded group members). The funded group members are contractually obliged to pay a percentage of any monies they recover to the Funder, whereas the non-funded group members are not.

Accordingly, if there is no differentiation between funded and non-funded group members in any settlement of the class action, the non-funded group members may stand to recover a greater proportion of their claimed losses as they are not obliged to pay a percentage of amounts they recover to a Funder.

This issue has been addressed in two ways in recent settlements. First, a number of settlements have used an 'equalisation factor' in calculating group member distributions.[72] An equalisation factor reduces the amount payable to non-funded group members and proportionally increases the amount payable to funded-group members so that the burden of the Funder's premium is effectively shared by all group members irrespective of whether they are funded or non-funded. The employment of an equalisation factor 'equalises' the position of funded and non-funded group members so that they stand to recover the same proportion of their claimed loss, but does not increase the amount payable to the Funder. The second method which has been proposed in at least two settlements (one of which was approved,[73] one of which was rejected),[74] involves the Funder being paid their full premium by funded group members *and* being paid additional premium by non-funded group members, the result being

that the Funder would recover *more* than they are contractually entitled to.

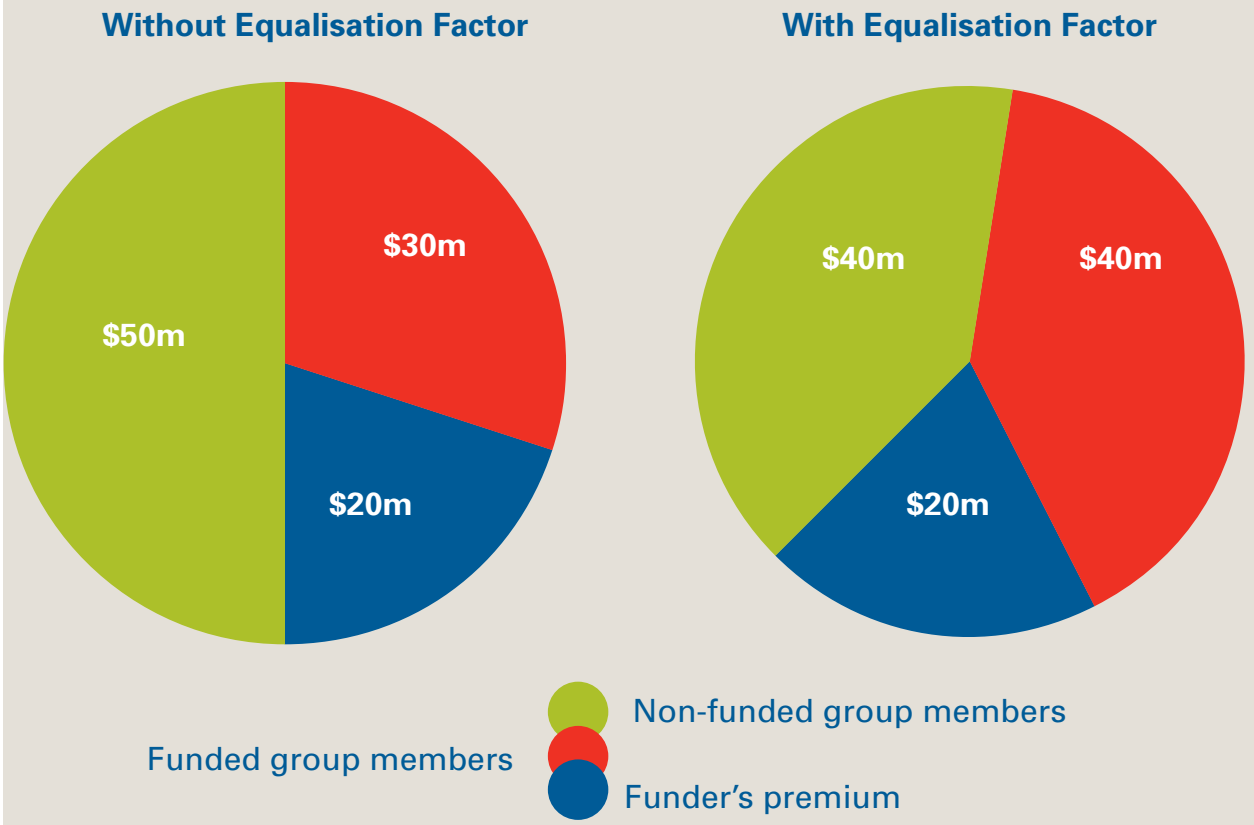
This section discusses settlements where these two mechanisms have been proposed and notes some of the issues to which they give rise, including:

- whether non-funded group members are adequately represented in the settlement of funded class actions;
- whether scrutiny should be given to the reasonableness of premiums extracted by Funders where an equalisation factor is proposed;
- the potential for conflicts of interest to arise between the interests of the representative applicant and funded group members, on the one hand, and the interests of non-funded group members, on the other; and
- the potential for abuse of class action settlements by Funders in order to extract a return beyond that to which they are legally entitled.

What is an Equalisation Factor?

A number of recent class action settlements have adopted equalisation factors. While these may differ in form, they should theoretically have the same mathematical effect. To take a simplified example, suppose there is a class action with 50 funded group members and 50 non-funded group members all with claims of equal value and strength, except that the 50 funded group members are contractually obliged to pay 40% of any individual net recoveries to their Funder. Suppose further that the class action settles and there is a sum of $100 million available for distribution to group members. If all group members are treated on the same basis in the settlement, each group member would recover $1 million, but each funded group member would be left with only $600,000 in hand after paying the 40% premium to their Funder. In the end, the 50 non-funded group members would receive $50 million, the 50 funded group members would receive $30 million and the Funder would receive the remaining $20 million. A typical equalisation factor will alter this situation so that the Funder continues to receive $20 million, but each group member (whether funded or non-funded) is left with $800,000 in hand after the funded group members' liabilities to the Funder are discharged.

Figure 5: Settlement Distribution With and Without Equalisation Factor



Is There Justification For An Equalisation Factor?

While the practice of employing equalisation factors has developed without extensive court scrutiny, there has been some passing discussion of their rationale. In approving the settlement of the *Aristocrat* class action,[75] Justice Stone noted:

> The difference in the amounts allocated to funded and non-funded group members is explained by the fact that the funded group members have undertaken liability for costs of the action through the litigation funder.[76]

In the *Multiplex* class action, Justice Finkelstein accepted a submission that:

> fairness to the funded class members, without whom the proceedings could not have continued, requires that the non-funded group members are in no better position for having been unfunded for a matter of weeks prior to the in-principal settlement having been reached.[77]

Finally, in the *GPT* class action,[78] Justice Gordon herself proposed an equalisation factor (having rejected the proposed 'extra premium' scheme discussed below) which was said to be necessary to avoid the non-funded group members receiving a "*windfall*."[79]

These arguments in favour of equalisation factors are redolent of those justifying the so-called common fund doctrine. Put broadly, the doctrine states that to allow non-parties to benefit from the plaintiff's efforts in pursuing litigation without contributing to the expenses of that litigation would allow the non-parties to be enriched unjustly at the plaintiff's expense. In the present context, the commitment by funded group members to pay premium to a Funder appears to have been treated by courts as a cost incurred in bringing the settlement fund into existence, and it is therefore said to be unfair for a non-funded group member to be able to claim from that fund without bearing its proportion of the costs incurred. A number of things may be said in response to this assertion.

FIRST, 'COMMON FUND' REASONING ONLY EXTENDS TO COSTS WHICH ARE REASONABLE AND WHICH ARE NECESSARY IN BRINGING ABOUT THE EXISTENCE OF THE FUND

If funded group members have agreed to pay an exorbitant or uncommercial level of premium, there is no reason why they should be entitled to recover those amounts from the settlement fund thereby diminishing the returns available to non-funded group members. As the Australian Law Reform Commission noted when discussing the common fund doctrine in the context of lawyers' fees:

> [A]ny commitment of part of the monetary relief recovered by group members to costs must be subject to appropriate regulation by the court to protect the group member.[80]

Given that the practice of including equalisation factors in settlements has developed in the absence of an express statutory basis and with little consideration of its fairness by the courts, it is not clear that any form of effective regulation exists to protect the interests of non-funded group members. If the practice is to be effectively regulated, the reasonableness of the premiums charged by Funders may need to be considered by the courts.

SECOND, WHILE A REPRESENTATIVE APPLICANT MAY HAVE A GENUINE CLAIM TO THE REIMBURSEMENT OF REASONABLE EXPENSES INCURRED IN PURSUING A CLASS ACTION TO SETTLEMENT, SUCH A CLAIM IS HARDER TO JUSTIFY ON BEHALF OF A FUNDED GROUP MEMBER

A funded group member is not a party to the proceeding and does not have conduct of it. Instead, they are simply a person who has made a voluntary commercial decision to enter into a private legal arrangement with a Funder. The rationale for allowing funded group members to defray the costs of that voluntary commercial decision at the expense of non-funded group members has not been adequately explained.

THIRD, IT IS ALWAYS OPEN TO A REPRESENTATIVE APPLICANT TO COMMENCE A CLOSED CLASS PROCEEDING, LIMITED TO THOSE WHO HAVE ENTERED INTO FUNDING AGREEMENTS, IF THEY ARE CONCERNED THAT NON-FUNDED GROUP MEMBERS WOULD GET A FREE RIDE IN AN OPEN CLASS PROCEEDING

A representative applicant who commences an open class proceeding and thereby agrees to represent the interests of funded and non-funded group members alike does so voluntarily and there is no reason why they should expect to be partially indemnified in respect of their private contractual obligations as a result (at least absent proper court scrutiny).

Conflicts of Interest Between Funded and Non-Funded Group Members in Open Class Proceedings

In representative proceedings, courts play a protective role and should be zealous to ensure that group members are not prejudiced by the conduct of litigation on their behalf. Ordinarily, a court in a class action can rely *"on the congruence of [group members'] interests with those of the representatives as the incentive for effective representation"* because *"the self-interest of the representative… drives the active party."*[81] That is not the case where a court is asked to consider the implementation of an equalisation factor. The representative applicant (whose lawyers will usually represent most or all of the funded group members) has a direct pecuniary interest in an equalisation factor being implemented as it will increase the distribution to which they (and all funded group members) are entitled. That interest is in direct conflict with the interests of non-funded group members, whose potential distributions are diminished in direct proportion to the increases received by funded group members.

It is true that a non-funded group member would be technically entitled to challenge the approval of an equalisation factor on the basis that it was neither fair nor reasonable. However, the ability of a group member to do so in practice is likely to be limited by a number of factors.

FIRST, THE DEGREE OF NOTICE THAT HAS BEEN GIVEN TO GROUP MEMBERS OF PROPOSED EQUALISATION FACTORS HAS BEEN LIMITED AT BEST

It is not possible to determine precisely how many settlements involving equalisation factors have been approved for this reason. Three examples of the degree of notice given of equalisation factors are given below.

SECOND, NON-FUNDED GROUP MEMBERS OFTEN LACK THE RESOURCES AND INCENTIVES NECESSARY TO SCRUTINISE OR CHALLENGE A SETTLEMENT

It is unrealistic to expect that unsophisticated group members with small claims could mount an effective court challenge to proposed discriminatory treatment, even if given proper notice, as it will usually not be economically feasible for them to do so. To our knowledge, there is no case in which a court has questioned the propriety of an equalisation factor or where a court has scrutinised

AWB class action[82]	Fuel surcharges class action[83]	Aristocrat class action[84]
The Notice of Proposed Settlement made no mention of the fact that an equalisation factor was proposed. Instead, a non-funded group member would need to have requested and understood a confidential and complex Loss Assessment Formula in order to discover that it was proposed that they would be treated on a different basis from funded group members in the settlement. No judgment was published in relation to the approval of that settlement, and it is unclear whether the fairness or reasonableness of the equalisation factor was an issue considered by the Court.	The Notice of Proposed Settlement referred to the fact that the Funder's premium would be paid from the settlement amount and used the phrase 'equalisation payment,' but did not clearly explain what the 'equalisation payment' involved and, in fact, used that phrase in a manner which was confusing and internally inconsistent within the notice. Again, no judgment was published in relation to the approval of that settlement, and it is unclear whether the fairness or reasonableness of the equalisation factor was an issue considered by the Court.	The Notice of Proposed Settlement stated that there would be $109 million available for distribution to funded group members and $27 million available for distribution to non-funded group members, however the method by which those sums were calculated was not explained. There was no explanation that this would lead to the non-funded group members recovering a lesser proportion of their claimed losses than funded group members, nor was it stated that non-funded group members were effectively being asked to subsidise the premium owed by funded group members.

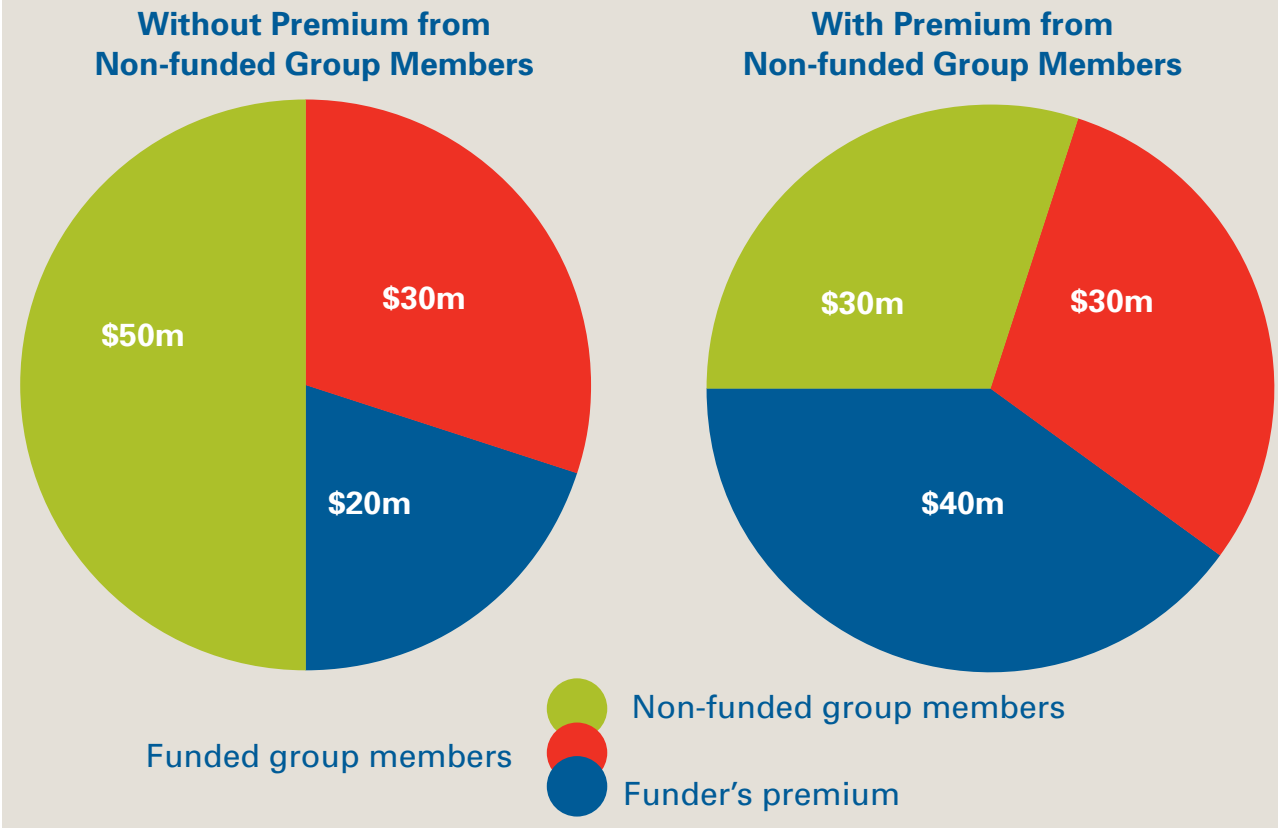
whether the premium paid to a Funder was a cost reasonably necessary to be incurred. For the reasons given above, it may be appropriate that a greater degree of scrutiny be applied in the future.

Funders Seeking Premium in Excess of Contractual Entitlements

In both the class action brought by Pathway Investments Pty Ltd against National Australia Bank Limited (NAB)[85] and the class action brought by Modtech Engineering Pty Ltd against GPT Management Holdings Ltd (GPT),[86] a settlement was proposed which would have involved payments being made to a Funder not just in respect of recoveries by funded group members, but also in respect of recoveries by non-funded group members. Those proposed schemes would have seen the Funder recovering a greater amount than that to which they were contractually entitled. The scheme was approved in the *NAB* class action but rejected in the *GPT* class action.

To re-work the example given above of the $100 million settlement with 50 funded group members and 50 non-funded group members, such a mechanism would see the Funder recovering their 40% premium not only from the recoveries of the 50 funded group members, but also from the recoveries of the 50 non-funded group members. The result would be that the Funder recovers $40 million rather than the $20 million to which it is contractually entitled, with $30 million left for the 50 funded group-members and $30 million left for the 50 non-funded group members.

Figure 6: Funder's Premium



NAB CLASS ACTION

The action against NAB was originally commenced as a closed class proceeding, with the class limited to those who had entered into a funding agreement with ILFP. In order to facilitate settlement, orders were sought and made by consent of the parties to the proceeding which had the effect of "opening" the class to include those who had not entered into funding agreements with ILFP but who otherwise met the group definition. Those new group members could either register to participate in any settlement or opt out of the proceeding or do nothing (in which case they would have no entitlement to any recovery). However, the consent orders also provided that those group members who registered would become obliged to pay a premium to ILFP, with whom they had no pre-existing contractual relationship. The orders made by the Court incorporated detailed terms of the kind normally found in a funding agreement, stating:

> Upon Resolution, each Registered Group Member will pay to the Funder or its nominee, from the Resolution Sum… [a]n amount equal to a percentage of the Net Resolution Sum where that percentage is determined by reference to the number of NAB shares purchased by the Registered Group Member in the period covered by the claims as follows:

Number of NAB Shares	Percentage of Net Resolution Sum
Less than 1 million	40%
Between 1 million and million (inclusive)	35%
More than 10 million	30%

The Court did not publish its reasons for requiring in the consent orders that registered group members pay a commission to ILFP. It is unclear whether any consideration was given to the appropriateness or otherwise of employing the coercive powers of the Court in a fashion which effectively constructs a funding agreement between a group member and a Funder as a condition of that group member participating in any settlement. In its reasons for approving the settlement itself, the Court did discuss the effect of the consent orders, stating:

> The original group members had each entered into agreements with the litigation funder agreeing to pay to the litigation funder a certain percentage of any distribution by reference to the number of the bank shares which they held... One of the [consent orders] provided for payments of comparable amounts by the registered group members (as defined). Group members potentially affected by this order have been on notice of its terms and none has objected. It is not for the Court to express a view about the commercial desirability of the quantum paid to the litigation funder under these arrangements, and there is no reason shown to withhold approval of the settlement because of the proportion of the settlement amount to be received by the litigation funder rather than by the group members themselves. In other cases it might be necessary for separate justification of the amounts paid to a litigation funder before the Court approves a settlement but that does not appear necessary in this instance. The amounts payable from the distribution to the original group

> members appear to have been agreed to between sophisticated parties with substantial means and neither they, nor the registered group members, have raised objection.[87]

While it may be true that no group member objected to the order that registered group members pay commission, it is not apparent that group members were actually notified of the fact that they had a right to object. The consent orders had already been made at the time notice of the settlement was given and the effect of those orders was not dependent upon approval of the settlement. It is therefore not clear whether any of the new group members in the opened class would have been in a position to object to those orders. The Court's reluctance to enquire into the "*commercial desirability*" of the contractual relationships between ILFP and funded group members is an entirely understandable and proper reflection of those parties' freedom to contract as private parties. It is less clear, however, that a court should display similar reluctance in circumstances where it is asked to use its powers to impose a funding agreement upon non-funded group members as a condition of participating in any settlement.

These are issues with which the Court was asked to grapple in the absence of any clear statutory framework and without the benefit of argument between opposing voices. The statement by the Court that separate justification of payments to a Funder might be required in other cases suggests that these issues may demand greater consideration in the future.

GPT CLASS ACTION

The *GPT* class action was also commenced as a "closed" class, but was subsequently opened by an amendment to the group definition. Unlike the *NAB* class action, no Court order at the time that the class was opened required group members who registered to pay a premium to a Funder, nor was any notice given of such a proposal to group members at the time they were asked to register. Nevertheless, when settlement was reached, it was proposed that commission should be paid to CLF in respect of settlement amounts allocated to the non-funded group members. Justice Gordon rejected the proposal, stating:

> The deduction of the funding commission was never part of a commercial bargain reached by CLF with these [non-funded group members]. In fact, for whatever reason, the [non-funded group members] decided to do the direct opposite and not enter into a LFA [litigation funding agreement]. What has changed? I can identify no reason why the LFA should now be imposed on the [non-funded group members]. They have not agreed to it.[88]

Instead, Justice Gordon suggested and approved the implementation of an equalisation factor of the kind discussed above.

The scheme originally proposed in the *GPT* class action would have delivered to CLF an amount greater than that to which it was contractually entitled at the expense of all group members. The fact that this was proposed at all suggests the potential for exploitation of the settlement process by Funders. It begs the question of why the

representative applicant or their lawyers agreed to such a scheme and whether they were able adequately and independently to represent the interests of funded and non-funded group members alike.

COMMERCIAL INCENTIVES OF FUNDED GROUP MEMBERS AND FUNDERS

The development of the two mechanisms discussed above reflects the pursuit of commercial self-interest by funded group members and Funders respectively, at the expense of non-funded group members:

- funded group members use equalisation factors to shift the burden of the premium they owe onto non-funded group members; and

- Funders have sought to maximise the amount of premium they are able to extract from group members by seeking premium over and above their contractual entitlements.

In the absence of any regulation of the conduct of funded class actions, the only check on such behaviour is the scrutiny of the Court on an approval hearing. There are powerful reasons to doubt that a funded representative applicant (or their lawyers) can adequately represent the interests of non-funded group members in a settlement hearing where a mechanism which discriminates against the interests of non-funded group members is proposed. In the absence of adequate representation, it would be unrealistic to suggest that courts can reliably identify and scrutinise all prejudicial treatment of non-funded group members.

As noted above, the level of notice given of these discriminatory mechanisms to non-funded group members has been limited at best and, even if adequate notice had been given, it is rarely the case that non-funded group members have the resources necessary to challenge such settlements. This is borne out by the recent experience in the class action commenced against Macquarie Bank Ltd arising from the collapse of Storm Financial.[90] That action was funded, not by a Funder, but by a sub-set of group members. The settlement proposed by the representative applicant, and approved at first instance, would have seen those group members who had contributed funds receiving substantially greater returns than those who had not. It was only because of the intervention of ASIC that this settlement was overturned on appeal as being neither fair nor reasonable.[91]

ASIC's intervention was a rare example where the approval of a class action settlement involved a genuinely contested hearing and one of very few cases in which a proposed settlement has been rejected. Several of the issues successfully raised by ASIC in opposing the settlement of the Storm proceeding (such as adequacy of notice to group members, absence of justification for differential treatment, and disproportionate return on investment) could quite properly have been raised in opposition to the equalisation and extra premium mechanisms approved in the Funder-driven class actions described above.

PROTECTION OF NON-FUNDED GROUP MEMBERS

The treatment of non-funded group members in recent class action settlements gives rise to real concerns that their interests are being prejudiced without proper representation or consideration. Any response to these concerns must address three interrelated issues:

- the potential conflict of interest between the interests of Funders, funded group members and non-funded group members;
- the degree and quality of notice given to group members of proposed discriminatory mechanisms; and
- the adequacy of representation of non-funded group members where court approval is sought of such mechanisms.

At the very least, group members must be given clear notice of any proposed discriminatory treatment in class action settlements. Where there is a real conflict between the interests of the representative applicant and the interests of non-funded group members, it may also be appropriate to consider whether non-funded group members require independent representation (e.g. by a sub-group representative or an amicus curiae) and whether, in particular cases, the cost of that representation ought be borne by the Funder or by funded group members. Finally, any regulation of or restrictions to the ability of Funders to exert control over the conduct of proceedings may diminish the risk that Funders will seek to exploit class action processes in order to extract returns in excess of their contractual entitlements.

Conclusion

TPLF presents a number of challenges to the administration to justice in Australia, including:

Increased Litigation

Statistical evidence indicates that TPLF increases the scale and complexity of litigation. This evidence accords with the examples of the impact TPLF has on litigation, including an increase in interlocutory disputes and the potential for parallel funding of parallel class actions. Furthermore, TPLF potentially increases the number of unmeritorious claims instituted as Funders are primarily concerned with class actions having sufficient scale, rather than the merits of individual claims.

Conflicts of Interest

The structure of TPLF heightens the risks of conflicts of interests arising and influencing the actions taken by lawyers. This is so because Funders are free to contract for almost exclusive control of litigation they fund, and the long term nature of relationships between Funders and law firms discourages lawyers from making decisions adverse to the interests of Funders, even if those decisions are in the best interests of clients. The establishment of Funders by law firms may further increase these risks.

Prejudice to Non-Funded Group Members

There is real reason for concern that the interests of non-funded group members are not being adequately represented or considered in the assessment of proposed settlements of funded class actions. The increasing use of equalisation factors and the cases in which additional premium has been sought by Funders highlight the conflict between the commercial incentives of funded group members and Funders, on the one hand, and the interests of non-funded group members, on the other. If non-funded group members are to be required to pay (whether directly or indirectly) commission to Funders, the reasonableness of that commission should be subject to court scrutiny and the interests of non-funded group members may require independent representation and consideration. At the very least, far greater notice of proposed discrimination between funded and non-funded group members should be required.

The mantra of Funders is that they provide increased access to justice. This is said to justify both the role played by Funders and the limited oversight that applies to them. However, the reality of TPLF is that cases

are chosen and run to maximise Funders' profits (which are substantial), and the extent to which TPLF provides access to justice for those who could not otherwise afford it is considerably overstated. Recent trends in case selection, class closure and class composition suggest that the additional access provided by TPLF is limited at best, and may not be justified by the attendant problems and risks which TPLF poses.

The issues discussed in this paper have arisen in the absence of meaningful government oversight of TPLF. In the case of class actions, the regime contained in the *Federal Court Act 1976* was developed when TPLF was prohibited. As a result, there is no legislative framework addressing a number of key issues, and courts have been asked to develop ad hoc and piecemeal solutions without any input from a number of affected stakeholders and with limited perspective on the systemic ramifications of those decisions. Given the unregulated and relatively young nature of TPLF in Australia, it is likely that further issues will emerge in the future.

These may include:

- what happens if a Funder collapses or walks away during the course of a class action;

- how the problem of competing class actions (with competing Funders and competing law firms) will be addressed; and

- whether Funders owe (or should owe) duties to both funded and non-funded group members.

Without a clear regulatory or legislative framework it is difficult to see how these issues will be resolved. Any programme of oversight should not only address existing issues with TPLF, but should anticipate those that may naturally occur as the practice of TPLF continues to gain an even stronger foothold in the civil justice system.

Endnotes

1 Justice Ronald Sackville, Speech delivered to the Class Actions Think Tank, 16 August 2012, as reported in Andrew Jennings, "Slice of the action", *Lawyers Weekly*, 4 December 2012, available at *http://www.lawyersweekly.com.au/features/slice-of-the-action.*

2 Explanatory Statement, *Corporations Amendment Regulation 2012 (No. 6)* - F2012L01549, available at *http://www.comlaw.gov.au/Details/F2012L01549/Explanatory%20Statement/Text*.

3 Chris Merritt, "Rising player sees danger ahead", *The Australian*, 24 May 2013, available at *http://www.theaustralian.com.au/business/legal-affairs/rising-player-sees-danger-ahead/story-e6frg97x-1226649540693*.

4 Wayne Attrill, "The Future of Litigation Funding in Australia" in Michael Legg, *The Future of Dispute Resolution* (LexisNexis Butterworths,1st ed, 2013) 167 at 169.

5 Including IMF (Australia) Limited, Hillcrest Litigation Services Limited, LCM Litigation Fund Pty Limited, Litigation Lending Services Limited (specialising in insolvency actions) and Quantum Funding Pty Ltd (family law claims) – smaller Australian entities; and overseas based Comprehensive Legal Funding LLC (US), International Litigation Funding Partners Pte Limited (Singapore) and Omni Bridgeway (The Netherlands). In March 2012, UK-based Funder Argentum Investment Management Ltd (with its UK and Australian operational subsidiary Argentum Litigation Services Limited) also entered the Australian market as, recently, has Claims Funding Australia Pty Ltd, associated with plaintiff law firm, Maurice Blackburn Lawyers. 2117980 Ontario Inc, a company incorporated in the Province of Ontario, Canada, was initially the funder of the *Multiplex* class action (*P Dawson Nominees Pty Ltd v Brookfield Multiplex Limited & Anor* (Federal Court proceeding VID 1380 of 2006)) before its interest was assigned to International Litigation Funding Partners Pte Ltd (see *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2008] FCA 1769 at [1]). It no longer appears to be operating in the Australian market.

6 Michael Legg, "Litigation Funding in Australia Identifying and Addressing Conflicts of Interest for Lawyers", *US Chamber Institute for Legal Reform*, 2012 at 4.

7 IMF website, available at *http://www.imf.com.au/funding.asp*.

8 In April 2013, IMF announced that, as a result of changes to the *Corporations Act 2001* (Cth), which exempt litigation funding schemes and arrangements from requiring an AFSL, IMF applied to the Australian Securities and Investments Commission to have its AFSL cancelled. IMF stated that ASIC granted the cancellation on 18 April 2013, but that it remained of the view that litigation funders operating in Australia should be licensed and that IMF will reapply for an AFSL should it be able to do so in the future: IMF website, available at *http://www.imf.com.au/docs/default-source/site-documents/-c46275e6-6eb3-467b-9aa6-82a5ed288917-_australian-financial-services-licence---19-apr-13*.

9 Hillcrest Litigation Services Limited's website, available at *http://www.hillcrestlitigation.com.au/profile/litigation-in-australia/*.

10 LCM Litigation Fund Pty Ltd website, available at *http://www.lcmlitigation.com.au/*.

11 Wayne Attrill, "The Future of Litigation Funding in Australia" in Michael Legg (ed), *The Future of Dispute Resolution* (LexisNexis Butterworths, 1st ed, 2013) 167 at 179.

12 The Hon Chris Bowen MP, "Government Acts to Ensure Access to Justice for Class Action Members" (Speech delivered at the Shareholder Class Action Conference, Sydney, 4 May 2010).

13 See, for example, Justice Keane, "Access to Justice and Other Shibboleths" (Speech delivered at the Judicial Conference of Australia Colloquium, Melbourne, 10 October 2009); Justice Sackville, Speech delivered to the Class Actions Think Tank, 16 August 2012; Justice McDougall, "Keynote Address" (Speech delivered at the New South Wales Young Lawyers' Civil Litigation Seminar, Sydney, 13 March 2010) at [36]; *Godfrey Waterhouse & Ors v Contractors Bonding Limited* [2013] NZSC 89 at [41].

14 Justice Ronald Sackville, Speech delivered to the Class Actions Think Tank, 16 August 2012, as reported in Andrew Jennings, "Slice of the action", *Lawyers Weekly*, 4 December 2012, available at *http://www.lawyersweekly.com.au/features/slice-of-the-action.*

15 David Abrams and Daniel Chen, "A Market for Justice: A First Empirical Look at Third Party Litigation Funding" (January 2012) *University of Pennsylvania Law School*, available at*https://www.law.upenn.edu/cf/faculty/dabrams/workingpapers/MarketforJustice.pdf* at 22; Dr George Barker, "Third Party Litigation Funding in Australia and Europe" (Centre for Law and Economics Working Paper No 2/2011, ANU College of Law, 13 December 2011) at 27.

16 See generally John Walker, Susanna Khouri and Wayne Attrill, "Funding Criteria for Class Actions" (2009) 32 *University of New South Wales Law Journal* 1036.

17 John Walker, Susanna Khouri and Wayne Attrill, "Funding Criteria for Class Actions" (2009) 32 *University of New South Wales Law Journal* 1036 at 1041.

18 Dr George Barker, "Third Party Litigation Funding in Australia and Europe" (Centre for Law and Economics Working Paper No 2/2011, ANU College of Law, 13 December 2011) at 26.

19 Dr George Barker, "Third Party Litigation Funding in Australia and Europe" (Centre for Law and Economics Working Paper No 2/2011, ANU College of Law, 13 December 2011) at 26–7.

20 John Walker (Executive Director of IMF (Australia) Ltd), "The Changing Funding Environment in Class Actions" (Paper presented at the Maurice Blackburn International Class Actions Conference, Sydney, 2007) at [1.1] ff 1. See also John Walker, "Selecting and Resolving Shareholder Claims" (Paper presented at UNSW Class Actions Seminar, Sydney, 29 August 2013) at [1.1]–[1.2].

21 John Walker, "The Changing Funding Environment in Class Actions" (Paper presented at the Maurice Blackburn International Class Actions Conference, Sydney, 2007) at [1.1]; John Walker, Susanna Khouri and Wayne Attrill, "Funding Criteria for Class Actions" (2009) 32 *University of New South Wales Law Journal* 1036 at 1049–53.

22 John Walker, "Selecting and Resolving Shareholder Claims" (Paper presented at UNSW Class Actions Seminar, Sydney, 29 August 2013) at [1.1]–[1.2].

23 John Walker, Susanna Khouri and Wayne Attrill, "Funding Criteria for Class Actions" (2009) 32 *University of New South Wales Law Journal* 1036 at 1047–8.

24 John Walker, Susanna Khouri and Wayne Attrill, "Funding Criteria for Class Actions" (2009) 32 *University of New South Wales Law Journal* 1036 at 1040.

25 John Walker, Susanna Khouri and Wayne Attrill, "Funding Criteria for Class Actions" (2009) 32 *University of New South Wales Law Journal* 1036 at 1047–8.

26 John Walker, Susanna Khouri and Wayne Attrill, "Funding Criteria for Class Actions" (2009) 32 *University of New South Wales Law Journal* 1036 at 1049–53.

27 Vince Morabito, "An Empirical Study of Australia's Class Action Regimes, Second Report: Litigation Funders, Competing Class Actions, Opt Out Rates, Victorian Class Actions and Class Representatives" (September 2010) at 38.

28 Ben Slade, "Developments in Funded Shareholder Class Actions" (Paper presented at UNSW Class Actions Seminar, Sydney, 29 August 2013) at [2.2].

29 John Walker, "The Changing Funding Environment in Class Actions" (Paper presented at the Maurice Blackburn International Class Actions Conference, Sydney, 2007) at [4.2].

30 *Dorajay Pty Ltd v Aristocrat Leisure Limited* [2005] FCA 1483 (Stone J).

31 *P Dawson Nominees Pty Ltd v Multiplex Ltd* [2007] FCA 1061 (Finkelstein J), affirmed in *Multiplex Funds Management Ltd v P Dawson Nominees* [2007] FCAFC 200 (French, Lindgren and Jacobson JJ).

32 Vince Morabito, "An Empirical Study of Australia's Class Action Regimes, Second Report: Litigation Funders, Competing Class Actions, Opt Out Rates, Victorian Class Actions and Class Representatives" (September 2010) at 39.

33 *Richard Kirby v Centro Properties Ltd & Anor* (Federal Court proceedings VID 326 of 2008 and VID 327 of 2008)*, Nicholas Vlachos & Ors v Centro Properties Ltd & Ors* (Federal Court proceeding VID 366 of 2008)*, Nicholas Stott v PricewaterhouseCoopers Securities Limited* (Federal Court proceeding VID 1028 of 2010) *and Nicholas Vlachos & Ors v Pricewaterhousecoopers* (Federal Court proceeding VID 1041 of 2010).

34 *Gaby Hadchiti & Ors v Nufarm Ltd* (Federal Court proceeding NSD 1847 of 2010).

35 *Anthony Scott & Anor v Oz Minerals Limited* (Federal Court proceeding NSD 1433 of 2010) and *Hobbs Anderson Investments Pty Limited v Oz Minerals Limited* (Federal Court proceeding NSD 1127 of 2009).

36 *P Dawson Nominees Pty Ltd v Brookfield Multiplex Limited & Anor* (Federal Court proceeding VID 1380 of 2006).

37 *P Dawson Nominees Pty Ltd v Brookfield Multiplex Limited (No 4)* [2010] FCA 1029 at [23] (Finkelstein J).

38 Maurice Dunleavy, "Centro class action focuses on insurance", *The Australian*, 6 March 2009.

39 John Walker, Susanna Khouri and Wayne Attrill, "Funding Criteria for Class Actions" (2009) 32 *University of New South Wales Law Journal* 1036 at 1041.

40 Damian Grave, Ken Adams and Jason Betts, "Class Actions in Australia" (2nd ed, 2012) at 802–3.

41 *De Brett Seafood Pty Ltd & Anor v Qantas Airways Limited & Ors* (Federal Court proceeding VID 12 of 2007).

42 See *Pathway Investments Pty Ltd v National Australia Bank* (Victorian Supreme Court proceeding No. 6249 of 2011), Order of 24 August 2012.

43 David Abrams and Daniel Chen, "A Market for Justice: A First Empirical Look at Third Party Litigation Funding" (January 2012) University of Pennsylvania Law School, available at *https://www.law.upenn.edu/cf/faculty/dabrams/workingpapers/MarketforJustice.pdf*.

44 Slater & Gordon, Annual Report 2013, p 7.

45 For example: *Matthews v SPI Electricity Pty Ltd & Anor (No 5)* [2013] VSC 285 (30 May 2013); *Green v CGU Insurance Ltd* [2008] NSWSC 390 (1 May 2008); *Marshall v Prescott (No 4)* [2012] NSWSC 992 (29 August 2012); *Re Global Medical Imaging Management Ltd (in liq)* [2001] NSWSC 476 (5 June 2001).

46 *Green v CGU Insurance Ltd* [2008] NSWCA 148.

47 For example: *Campbells Cash & Carry v Fostif Pty Ltd* (2006) 229 CLR 386; *Jeffery & Katauskas Pty ltd v SST Consulting Pty Ltd* (2009) 239 CLR 75; *Deloitte Touche v JP Morgan* (2007) 158 FCR 417.

48 *The application of Claims Funding Australia as Trustee for the Claims Funding Australia Trust* (Federal Court proceeding NSD 630 of 2013).

49 King & Wood Mallesons, "Class Actions in Australia – The Year in Review 2012", at 6, available at *http://www.mallesons.com/Documents/Class_Actions_in_Australia-The_Year_in_Review_2012.pdf*.

50 The settlement of the Centro class actions was approved by Justice Middleton: *Kirby v Centro Properties Ltd (No 6)* [2012] FCA 650.

51 While the return of IMF is public information, the return of CLF is not.

52 *Anthony Scott & Anor v Oz Minerals Limited* (Federal Court proceeding NSD 1433 of 2010) and *Hobbs Anderson Investments Pty Limited v Oz Minerals Limited* (Federal Court proceeding NSD 1127 of 2009).

53 IMF 2011 Annual Report at16, available at *http://www.imf.com.au/pdf/AnnualReport2011.pdf*.

54 The settlement of the two proceedings was jointly approved in July 2011: *Hobbs Anderson Investments Pty Limited v OZ Minerals Limited* [2011] FCA 801; see also *Scott v OZ Minerals* [2013] FCA 182.

55 *Gaby Hadchiti & Ors v Nufarm Ltd* (Federal Court proceeding NSD 1847 of 2010).

56 *Godfrey Waterhouse & Ors v Contractors Bonding Limited* [2013] NZSC 89 at [42].

57 *Emmanuel Management Pty Ltd (In Liq) v Foster's Brewing Group Ltd* (2003) 178 FLR 1.

58 Justice Keane, "Access to Justice and Other Shibboleths" (Speech delivered at the Judicial Conference of Australia Colloquium, Melbourne, 10 October 2009) at 8; see too *Godfrey Waterhouse & Ors v Contractors Bonding Limited* [2013] NZSC 89 at [42].

59 *Emmanuel Management Pty Ltd (in liquidation) & Ors v Foster's Brewing Group Ltd & Ors and Coopers & Lybrand & Ors* [2003] QSC 299 at [19]–[31].

60 NSW Law Reform Commission, "Security for Costs and Associated Costs orders" (December 2012) at [3.3].

61 *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386.

62 See too: LCM Litigation Fund Pty Limited, "Litigation Funding & Management Agreement", available at *https://clientportal.piperalderman.com.au/whitesands/LCM%20Funding%20Agreement.pdf*, which forbids a group member from having any communications in regard to settlement with any defendant, including through any solicitors retained in the matter, without the prior written agreement of the Funder.

63 See, for example, the Litigation Lending Services Limited agreement, available at *http://www.litigationlending.com.au/public/download/Funding_Agreement.pdf*, which allows plaintiffs to instruct the solicitors.

64 John Walker, "Litigation Funding Rules Face Scrutiny", *The Australian*, 2 August 2013.

65 See, for example, the eight Bank Fee class actions; *De Brett Seafood Pty Ltd & Anor v Qantas Airways Ltd & Ors* (Federal Court proceeding VID 12 of 2007); and *Stephen Hopkins v AECOM Australia Pty Ltd* (Federal Court proceeding NSD 757 of 2012).

66 Justice Keane, "Access to Justice and Other Shibboleths" (Speech delivered at the Judicial Conference of Australia Colloquium, Melbourne, 10 October 2009) at 7.

67 Alex Boxsell, "Law firm bankrolls litigation funder", *Australian Financial Review,* 19 April 2013; Alex Boxsell, "Judge probes lawyers' horse flu damages case", *Australian Financial Review*, 26 July 2013; *The application of Claims Funding Australia as Trustee for the Claims Funding Australia Trust* (Federal Court proceeding NSD 630 of 2013).

68 Justice Keane, "Access to Justice and Other Shibboleths" (Speech delivered at the Judicial Conference of Australia Colloquium, Melbourne, 10 October 2009) at 7.

69 As disclosed by Lee SC in a directions hearing for *The application of Claims Funding Australia as Trustee for the Claims Funding Australia Trust* (Federal Court proceeding NSD 630 of 2013, 19 September 2013 at 2.15pm).

70 *Waterford v The Commonwealth* (1987) 163 CLR 54 at 70.

71 RG 248.22.

72 For example, the proceedings listed in end notes 78, 82, 83 and 84 below. An equalisation factor was also employed in *Gaby Hadchiti & Ors v Nufarm Ltd* (Federal Court proceeding NSD 1847 of 2010).

73 *Pathway Investments Pty Ltd & Anor v National Australia Bank Limited (No 3)* [2012] VSC 625.

74 *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 626.

75 *Dorajay Pty Ltd v Aristocrat Leisure Ltd* (Federal Court proceeding NSD 362 of 2004).

76 *Dorajay Pty Ltd v Aristocrat Leisure Ltd* [2009] FCA 19 at [17].

77 *P Dawson Nominees Pty Ltd v Brookfield Multiplex Ltd (No 4)* [2010] FCA 1029 at [28].

78 *Modtech Engineering Pty Ltd v GPT Management Holdings Ltd* (Federal Court proceeding VID 1408 of 2011).

79 *Modtech Engineering Pty Ltd v GPT Management Holdings Ltd* [2013] FCA 626 at [58].

80 Australian Law Reform Commission, "Grouped Proceedings in the Federal Court" (Report No 46) at [289].

81 Yeazell, "From Group Litigation to Class Action, Part I: The Industrialization of Group Litigation" (1980) 27 *UCLA Law Review* 514 at 522, quoted with approval by McHugh J in *Carnie v Esanda Finance Corporation Ltd* (1995) 182 CLR 398 at 429.

82 *John Watson & Kaye Watson in their own right as representatives of the Group Members v AWB Ltd* (Federal Court proceeding NSD 2020 of 2007).

83 *Paxtours International Travel Pty Ltd v Singapore Airlines Ltd* (Federal Court proceeding NSD 787 of 2007).

84 *Dorajay Pty Ltd v Aristocrat Leisure Ltd* (Federal Court proceeding NSD 362 of 2004).

85 *Pathway Investments Pty Ltd v National Australia Bank* (Victorian Supreme Court proceeding No. 6249 of 2011).

86 *Modtech Engineering Pty Ltd v GPT Management Holdings Ltd* (Federal Court proceeding VID 1408 of 2011).

87 *Pathway Investments Pty Ltd & Anor v National Australia Bank Limited (No 3)* [2012] VSC 625.

88 *Modtech Engineering Pty Ltd v GPT Management Holdings Limited* [2013] FCA 626 at [57].

89 *Richards v Macquarie Bank Ltd* (Federal Court proceeding QUD 590 of 2010).

90 *Richards v Macquarie Bank Ltd (No 4)* [2013] FCA 438.

91 *Australian Securities and Investments Commission v Richards* [2013] FCAFC 89.

U.S. CHAMBER
Institute for Legal Reform

202.463.5724 main
202.463.5302 fax

1615 H Street, NW
Washington, DC 20062

instituteforlegalreform.com

Appendix II

Improving the Environment for Business in Australia – A Proposal for Oversight of Litigation Funding
http://www.instituteforlegalreform.com/uploads/sites/1/Australia_TPLF_Final.pdf

Improving the Environment for Business in Australia

A Proposal for Reforming Oversight of Third Party Litigation Financing

SEPTEMBER 2013

U.S. CHAMBER
Institute for Legal Reform

An Affiliate of the U.S. Chamber of Commerce

© U.S. Chamber Institute for Legal Reform, September 2013. All rights reserved.

This publication, or part thereof, may not be reproduced in any form without the written permission of the U.S. Chamber Institute for Legal Reform. Forward requests for permission to reprint to: Reprint Permission Office, U.S. Chamber Institute for Legal Reform, 1615 H Street, N.W., Washington, D.C. 20062-2000 (202 463 5724).

Table of Contents

Introduction	2
What is TPLF?	4
Problems Posed by TPLF	5
Proposed Reform of the Oversight Regime	9
Conclusion	16
About the U.S. Chamber Institute for Legal Reform	17
Appendix A—Options for Oversight Agencies	18
Appendix B—Options for an Oversight Regime	19
End Notes	21

Prepared by the U.S. Chamber Institute for Legal Reform

Introduction

In recent years, the use of third party litigation financing ("TPLF") in Australia has resulted in a notable proliferation of class actions and other funded lawsuits. The growth of the lawsuit investment industry has occurred largely without government oversight, giving rise to serious issues yet to be addressed. As a result, the increase in TPLF-financed litigation has in turn increased the cost of doing business in Australia, a trend which will continue if the current situation remains unchanged. The U.S. Chamber Institute for Legal Reform ("ILR") has grave concerns about this development, which has implications not only for the Australian civil justice system and economy but globally as well. ILR supports reform of the oversight regime governing TPLF in Australia in a way that will address the problems that the growth of TPLF poses.

The TPLF industry began as a financing instrument for the insolvency market. Its robust expansion, however, can be traced to the High Court of Australia's 2006 decision in *Campbells Cash and Carry Pty Ltd v. Fostif Pty Ltd.*[1] A majority of the High Court held that a third party investor in litigation may exercise significant control over the litigation and that this control is not an abuse of process and does not offend public policy where maintenance and champerty have been abolished as crimes and torts. The minority opinion harshly criticised third party investments in litigation, stating that the "purpose of court proceedings is not to provide a means for third parties to make money by creating, multiplying and stirring up disputes in which those third parties are not involved and which would not otherwise have flared into active controversy."[2] The majority, however, held that once the doctrines of champerty and maintenance were eliminated, there was no public policy against third party funding and a funder's control of litigation. The High Court's endorsement of a funder's control over the conduct of cases goes further than any other jurisdiction of which ILR is aware in opening litigation to the control of market forces.

Over the past seven years, the resulting acceleration of litigation instigated and financed by TPLF companies has gone largely unchecked, with new funders entering the market to share in lucrative returns from the forced-settlement model that has become standard in the industry.[3] In 2012, securities class action settlements alone exceeded $480 million, or nearly half of total settlements of that kind in Australia in the past twenty years. Over half of these 2012 settled proceedings were funded by TPLF.[4] This signals a global trend in which Australia is the leader.

Despite this dramatic change in the litigation landscape, the government has taken a largely hands-off approach to oversight of the TPLF industry. Indeed, the current state of affairs is an anomaly. Although Australian courts have characterized TPLF in different ways, TPLF

investors fundamentally provide a financial service to claimants. Like other financial service providers, they conduct funding activity and manage financial risk (in this instance, litigation risk). Yet, unlike other financial service providers, TPLF companies operate with minimal oversight. Recent measures such as *Corporations Amendment Regulation 2012 (No. 6)* and the Australian Securities and Investments Commission's Regulatory Guide 248[5] are insufficient safeguards, allowing TPLF investors to mirror the role of lawyers by exerting significant control over litigation without the constraints applicable to the legal profession. This conspicuous gap in the regulatory regime encourages speculation on litigation in Australia from investors around the world, with a near total lack of accountability.[6]

The unchecked acceleration of litigation controlled by strangers to the underlying dispute has implications for Australia's civil justice system, the cost of doing business in Australia and its global reputation as an investment destination. Effective oversight should be the natural and necessary consequence of TPLF's prevalence in Australia. *Fostif* created the opportunity for pervasive third party investment in, and control over, lawsuits; the exercise of that opportunity requires appropriate oversight of how those investments are made and how that control is exercised in order to protect consumers, business and the courts.

The time has come to reform the oversight regime applicable to TPLF investors.[7] As this paper will describe in more detail, a combination of three policy actions will mitigate the risks posed and harms caused by TPLF:

A. COMMONWEALTH LEGISLATION

- Commonwealth legislation should be enacted that establishes a licensing regime for TPLF investors. They should be licensed to ensure their fitness, including their capital adequacy. This regime should be enforced by an experienced independent statutory body, which should have the authority to commence proceedings, obtain civil penalties for violations, make banning orders and vary the TPLF license conditions.

B. LEGISLATIVE SAFEGUARDS

- Oversight reforms should include legislative safeguards against the risks inherent in TPLF. These legislative changes would not require significant modifications to the current statutory scheme. Rather, they would represent a "light-touch" approach to regulation that would nonetheless provide significant improvements to the current situation.

C. COURT AND OTHER RULES

- Commonwealth and state legislation or court rule amendments should be passed:

  (a) specifying that TPLF investors are jointly and severally liable for adverse costs orders; and

  (b) clarifying that TPLF investors may not engage in actions that are tantamount to the practice of law or hold themselves out to the public as lawyers for hire without the appropriate professional licensing applicable to all lawyers.

What is TPLF?

A TPLF investor is a specialized investment firm that has no other connection to a case but provides financing to claimants or their lawyers for litigation costs, including lawyers' fees, court costs and expert-witness fees, in exchange for a portion of any recovery from the dispute. The claimant's law firm and the TPLF investor typically work closely together to identify claims to file and to solicit claimants in whose name to file them. In addition, TPLF investors monitor the litigation, frequently instruct lawyers (or at least consult with them) regarding litigation strategy, and often drive settlement negotiations.[8] While TPLF has been used to finance insolvency and other proceedings, the principal area of growth has been the prosecution of complex torts or business disputes and class actions in return for a share of any award.

The investor's return is usually a portion of any recovery that the claimant receives from the resolution of the dispute, whether through final judgment or settlement. The amount of recovery the TPLF investor will charge turns on several factors, including the amount of money advanced, the length of time until recovery, the potential value of the case and whether the case settles or goes to trial.

TPLF funding arrangements generally are non-recourse (in whole or in part); the recipient of the funds obtains money to pursue a proceeding and is only required to provide a return to the TPLF company if the recipient obtains a damages award at trial or settles on favorable terms. The non-recourse nature of TPLF, where the return to the investor is contingent upon the outcome of a specified dispute, is what differentiates TPLF from other forms of credit. On the other hand, funding arrangements may allow the TPLF investor to discontinue funding at any point without constraint or may allow the investor to decline to pay an adverse costs order, leaving the claimants to foot the bill.

> *"This is an area ripe for abuse and the government has let the grass grow under its feet in not identifying and anticipating the extent to which abuses and opportunistic claims are being brought."*
>
> *–Senator George Brandis*

Problems Posed by TPLF

TPLF has at least three negative consequences for the sound administration of civil justice. Several ILR publications, as well as publications by other authors, have explained these consequences in more detail, but briefly they are:

First, TPLF increases the number of claims filed, and in particular, can be expected to prompt an increase in the number of claims of questionable merit. That TPLF increases the number of claims filed is simply an extension of the fact that TPLF increases the number of dollars to fund claims. A 2010 NERA Economic Consulting study of securities class actions in Australia found that "[t]he availability of commercial litigation funding has improved the incentive and ability for investors to initiate class actions."[9] Indeed, the managing director of IMF (Australia), the country's largest TPLF company, stated on ABC TV's *Lateline* that the increased availability of TPLF in Australia is behind the growing number of class actions and large litigation cases.[10]

Moreover, TPLF can be expected to prompt an increase in questionable and meritless claims because TPLF companies are mere investors. They base their funding decisions on the present value of their expected return, of which the likelihood of success at trial is only one component. TPLF providers can accept weaker cases because they can spread the risk of any particular case over their entire portfolio of cases and among their investors.[11]

TPLF's defenders say that investors' willingness to file lawsuits increases "access to justice." What this really means, however, is that TPLF makes it easier for a claimant to file a lawsuit and force a defendant to incur costs to appear and defend against it—and on occasion, force a settlement on purely reputational or legal costs grounds. The United States has had its own experiment with increasing "access to justice": contingent lawyer fees. Contingency fees and TPLF are strikingly similar—in both cases, a claimant can pass off the risk of pursuing a lawsuit to a third party on a non-recourse basis, meaning that the claimant has every incentive to roll the dice and file a claim. But at least in the case of contingent lawyer fees, the ultimate decision of whether a claim is worth filing sits with a lawyer who is bound by professional rules of conduct. In the case of TPLF, the person deciding whether or not a claim is worth filing is a third party investor who may owe no duties to the potential claimant. Thus, while a contingency fee lawyer will decide whether or not to file a claim based at least in part on the strength of its legal merit, a TPLF investor looks at the present value of the expected return, of which the legal merit is only a part.

The most notorious example of TPLF supporting a meritless claim was the investment by a fund associated with Burford Capital Limited in a lawsuit against Chevron filed in an Ecuadorian court alleging environmental contamination in

Lago Agrio, Ecuador. Burford made a $4 million investment with the claimants' lawyers in the Lago Agrio suit in October/November 2010 in exchange for a percentage of any award to the claimants. In February 2011, the Ecuadorian trial court awarded the claimants an $18 billion judgment against Chevron.[12] A New York federal court subsequently issued an injunction against the claimants trying to collect on their judgment after finding "ample" evidence of fraud on the part of the claimants' lawyers.[13] Indeed, long before Burford had made its investment in the case, Chevron had conducted discovery into the conduct of the claimants' lawyers, and at least four courts in the United States had found that the Ecuadorian proceedings were tainted by fraud.[14] An international arbitration tribunal convened under the U.S.-Ecuador Bilateral Investment Treaty and administered by the Permanent Court of Arbitration at The Hague recently ordered the Republic of Ecuador "to take all measures necessary to suspend or cause to be suspended the enforcement and recognition within and without Ecuador of the judgments [against Chevron]."[15]

While Burford has announced it ceased funding,[16] its initial decision to invest $4 million with the claimants' lawyers despite allegations of fraud in the proceedings powerfully demonstrates that TPLF investors have high risk appetites and are willing to back claims of questionable merit. Indeed, Burford sold an interest in its investment in this litigation to another investor.

Second, by inserting a third party into a decision-making role, TPLF diminishes the lawyer-client relationship and sets up conflicts among the investor, the lawyer and the claimant. TPLF investors seek to protect their investments in litigation and exert control over the strategic decisions that, absent TPLF, have traditionally been made by claimants and their counsel. And, unlike a claimant who is interested in vindicating legal rights, the investor is interested solely in its own profits. Moreover, when the claimant's lawyer accedes to the control asserted by the investor, no one remains to protect the claimant's interests—especially when the TPLF investor's interests diverge from the claimant's.[17] ASIC has recognized the conflicts of interest that TPLF creates, and *Corporations Amendment Regulation 2012 (No. 6)* attempts to address them by requiring TPLF investors to have procedures to manage conflicts. Given the TPLF investor's relentless focus on its own profits, and its sole power over the purse, however, ILR does not believe that detrimental conflicts of interest can be managed—they need to be avoided altogether.

The recent case *Kirby v. Centro Properties Limited* provides an example of the conflicts-of-interest problem.[18] *Kirby* involved three related class actions against common defendants—two funded by IMF (Australia) and represented by Maurice Blackburn, and a third funded by Commonwealth Legal Funding LLC and represented by Slater & Gordon. The defendants agreed with IMF (Australia) and Maurice Blackburn that they would move to stay the action funded by Commonwealth Legal Funding LLC if IMF (Australia) and Maurice Blackburn would cause the claimants in their actions to move to incorporate the Commonwealth Legal Funding LLC-funded action into their case. Although the court ultimately incorporated the Commonwealth Legal Funding LLC-

funded action into the IMF (Australia)-funded actions, it noted its concern that IMF (Australia) and Maurice Blackburn were conflicted: they had a pecuniary interest in removing Commonwealth Legal Funding LLC as a recipient of settlement funds, but incorporating the Commonwealth Legal Funding LLC-funded action into their actions made a beneficial settlement for their own clients less likely because of the nature of the Commonwealth Legal Funding LLC action and the number of potential claimants in it.

Third, TPLF prolongs litigation by deterring settlement. A plaintiff who must pay a TPLF investor out of the proceeds of any recovery can be expected to reject what may be a fair settlement offer, hoping for a larger sum of money.[19] In addition, litigation funding agreements also contribute to this problem. In Australia, typically these agreements provide the investor a greater percentage of any recovery the longer the dispute is pending. This incentivises TPLF investors to instruct claimants' counsel to reject early settlement offers to attempt to drag out the litigation—which, under *Fostif*, TPLF investors are permitted to do.

Indeed, in the first empirical study of the effects of TPLF, researchers found that increased litigation funding in Australia was "associated with slower case processing, larger backlogs, and increased spending by the courts."[20] The same study unambiguously concluded that, in Australia, "an increase in activity of litigation funders leads to more sclerotic courthouses."[21]

The evidence shows that each of these consequences is already happening. The incidence of filed and threatened law suits with TPLF has steadily increased with new funders entering the market to share in lucrative returns from the forced-settlement model that has become standard in the industry. The class action industry in Australia has matured rapidly over the past 20 years, with the potential to become the jurisdiction of choice for plaintiffs, lawyers and funders promoting class actions.[22] Since 2000, IMF (Australia) has funded 142 completed cases generating revenue of US $1.237 billion, making a gross return on investment of 304 percent.[23] Some outside of Australia are already taking notice. In April 2013, a UK-based "class-action services provider" established offices in Australia after estimating that annual class action settlements in the region will reach US $3.4 billion by 2020, the largest regional total outside the United States.[24] This unchecked acceleration in litigation has implications for Australia's civil justice system, the cost of doing business in Australia and its global reputation as an investment destination.

TPLF funding agreements and actions show that TPLF investors are exerting significant control over litigation they agree to fund, invariably with the sole goal of profit maximisation. This degree of influence arises because the funding agreements generally provide for, among other things, TPLF investors to exercise their discretion to:

(a) investigate the evidentiary basis for the claims so as to assist in the preparation of the case and review whether to continue to provide funding;

(b) investigate the capacity of any defendant to pay any judgment sum;

(c) provide project management services including advising the claimant on strategy, considering the advice of the lawyers and providing day-to-day instructions to the lawyers and seeking compliance with project estimates and timelines; and

(d) pay the costs of litigation (such as the lawyers' fees and investigation costs).

In some TPLF agreements there is an obligation that the claimant must instruct the lawyers to comply with all instructions given by the TPLF investor. Unless the claimant has the prior written consent of the TPLF investor, the claimant is also prevented from commencing, discontinuing, abandoning or settling the case.[25] However, TPLF investors have wide latitude to terminate their obligations under the funding agreement and withdraw their funding from the litigation. The funding agreements often contain an exclusion clause by which the TPLF investor does not and is not intended to owe fiduciary obligations to the claimants to act for their benefit.

At the same time, the role of legal counsel and claimants' interests are diminished and relegated to secondary status behind those of the TPLF investors who are effectively calling the shots—and taking a large portion of any settlement amount. This also calls into question who the lawyer's "client" is—the claimant or the funder—and raises the ethical issue of whether the lawyer is appropriately discharging the duty to act in the actual client's best interests. Increasingly, the funders are "partnering" with lawyers to get a case up and running. Often, lawyers are using court processes such as subpoenas and discovery to obtain access to details of potential class members so that they and the TPLF investors can contact those members to determine whether they want to be involved in the class action. This is the "book build" process which is critical to any litigation funder in determining whether to fund the litigation.

Additionally, funders' standard arrangements often have the potential to prolong litigation, especially in collective actions where there is no individual claimant directing the litigation. The terms of funding agreements typically provide for a greater percentage for the funder the longer a case goes on. The funding agreements often structure the TPLF investor's percentage take based on certain milestone dates if the resolution of the case is reached on or after a specified date and/or before another specified date. While this ostensibly is compensation for a longer term of investment, in reality it provides an incentive for funders effectively controlling the litigation to hold out for more attractive settlement offers over time, regardless of whether claimants' interests would be better served by reasonable settlements earlier in the litigation.

> *"The class action industry in Australia has matured rapidly over the past 20 years, with the potential to become the jurisdiction of choice for plaintiffs, lawyers and funders promoting class actions."*
>
> *–Stuart Clark, Clayton Utz*

Proposed Reform of the Oversight Regime

Greater safeguards against the dangers inherent in TPLF should be implemented through reforms to the government oversight regime in Australia. The risks posed by TPLF are so serious, and the incentives for misconduct by TPLF providers are so great, that industry self-regulation is not a viable option. In addition, government oversight and regulation of TPLF are proper because TPLF investors use litigation proceedings—and compulsory court processes—as investment vehicles. In other words, TPLF investors make money by co-opting the coercive power of government to command defendants to appear in court or before arbitrators, turn over documents and defend themselves. In these circumstances, regulating TPLF investors' actions is an entirely proper function of government. A Commonwealth regime of "light touch" regulation is the most sensible and effective way to address TPLF. From a practical standpoint, implementing a regulatory regime to govern TPLF will be more effective and straightforward than attempting to achieve harmonised state systems. Adopting Commonwealth TPLF rules, laws and regulations would ensure that one oversight regime is in place that covers all of the states. Such an approach would avoid a checkerboard of disparate state laws, rules and regulations which likely would funnel funded cases to the state courts in the states with the weakest oversight regimes. Issues that would still need to be addressed at a state level, discussed below, could be handled by the appropriate court or government body.

In particular, oversight of TPLF should be strengthened in three ways: (a) an appropriate independent Commonwealth authority should be designated to oversee TPLF regulation; (b) a regime of statutory safeguards should be adopted that governs both the practice of TPLF and the entities that practise it, and which could be enforced by the designated agency; and (c) there should be Commonwealth and state legislation or court rule changes specifying that TPLF investors are jointly and severally liable for adverse costs orders, clarifying that TPLF investors may not engage in actions that are tantamount to the practice of law without the appropriate professional licensing applicable to all lawyers, and restricting law firms from acting in matters funded by a TPLF investor in which they have an economic interest. We address each of these efforts below.

A. Commonwealth Legislation

The first step in our proposed oversight regime is to appoint an agency to oversee TPLF regulation. The designated body would be given authority to licence TPLF investors and to enforce its rules and any laws and regulations governing TPLF investments. There may be various options as to the most appropriate oversight agency.[27]

1. LICENSING

Commonwealth legislation should be enacted that improves oversight of the TPLF industry and that would be administered and enforced by the designated government agency. The proposed legislative framework would impose a licensing regime on TPLF investors. Such a legislative regime could adopt and augment the existing regulatory framework in Chapter 7 of the Australian Corporations Act relating to financial products and the provision of financial services so that litigation funders are subject to obligations similar to those applicable to providers of financial services.[28]

At the least, an effective licensing regime would need the following components:

(a) As a condition of obtaining a licence to operate, a TPLF investor must disclose the identity and relevant interests of all members of the TPLF investor's board of directors and all senior executive officers.

(b) Any applicant for a licence to invest in lawsuits must undergo an audit by the oversight agency to ensure its financial soundness, and must maintain liquid capital reserves equal to at least twice the amount of its investments in lawsuits. This high capital-adequacy requirement would help to ensure that the investor could pay legal fees, disbursements and any adverse costs order in the event the litigation is unsuccessful. We anticipate that capital-adequacy requirements for TPLF investors would mirror AFSL capital requirements.

(c) Any applicant should be required to post a substantial bond. This money would remain in an account administered by the oversight agency, with any interest or dividends going to fund enforcement and oversight activities by the agency.

(d) Any applicant must demonstrate that it has policies and procedures in place to ensure compliance with the TPLF oversight regime proposed here, including training its employees regarding compliance.

In administering this licensing regime, the oversight body would issue regulatory guidelines on how it will interpret and apply the law. See Appendix B for a detailed description of various options for a licensing regime to regulate TPLF.

2. ENFORCEMENT

The oversight agency should also have meaningful authority to ensure compliance with the laws governing TPLF investments. As part of this authority, it should be able to commence enforcement proceedings, obtain civil penalties for violations, make suspension or banning orders and vary the TPLF licence conditions. It should also have the power to seek scaled monetary penalties against violators, based upon the seriousness of the offence, which could be enhanced for repeat violations.

B. Legislative Safeguards

In addition to appointing a regulatory authority to oversee TPLF investments, Parliament should implement further legislative safeguards to be enforced by that agency. These safeguards should be of two types: statutory provisions that would govern TPLF investers generally, and statutory provisions relevant to TPLF investments in particular disputes.

1. PROVISIONS GOVERNING TPLF INVESTORS GENERALLY

(a) Prohibition on Law Firms Representing a Party in Matters Funded by TPLF Investors in Which They Have a Financial Interest

Law firms that have an ownership interest in a TPLF investor funding a case should not be permitted to act for a party in the same matter. Permitting a law firm with an ownership interest in a TPLF investor to offer legal advice in a matter funded by that investor diminishes the quality of legal advice available to clients in at least two ways:

(i) First, lawyer investors may focus more on the TPLF investor's profit prospects than on their clients' interests. This is likely to be a particular problem in class actions where there is typically no claimant directing the suit to whom the lawyer would report.

(ii) Second, financial ties between the lawyer and the TPLF further dilutes the already diminishing role of the client in the legal system as lawyers are pulled by the interests of the influential investor more so than the interests of their clients.

The overriding duty of a lawyer is to act in the best interests of the client. As fiduciaries, lawyers have an obligation to prefer their clients' interests over their own. A legal practitioner should be acutely aware of the fiduciary nature of the relationship with their clients, and always deal with their clients fairly, free of the influence of anything which may conflict with a client's best interests.[29] A legal practitioner must not accept instructions to act for a person in any proceedings or continue to act for a person engaged in such proceedings when the practitioner is, or becomes, aware that the person's interest in the proceedings is, or would be, in conflict with the practitioner's own interest or the interest of an associate.[30]

The concern with law firms that own TPLF companies also acting in a funded matter is that this duty is compromised. For any given client, the same lawyer would have a duty to the TPLF investor to maximise profit, but at the same time owe a duty to the client to maximise the amount of the claim. Often these duties will clash. While a lawyer would defer to the interests of the client, a TPLF investor has no such incentive or obligation.

At present, there is no express legislative prohibition against a law firm having a financial interest in a TPLF investor also acting in a funded matter for one of the parties in the case. However, the problems with this practice have been recognised.[31]

(b) Breach Reporting

Legislation should require TPLF investors to report any breach of the laws, regulations or rules governing TPLF to the oversight agency.

Failure to report a breach should itself constitute a breach. This would bring TPLF regulation in line with requirements applicable to other financial services licensees.[32]

(c) Funding Agreements

As a condition of licensing, TPLF investors should be required by legislation to include in their funding agreements an indemnity in favour of the claimant to pay adverse costs.

There is currently no express legislative obligation imposed on TPLF investors to assume the risk of meeting an adverse costs order.[33] Court rules permit courts to exercise a discretion to make a costs order against a non-party (such as a litigation funder) in the interests of justice. However, absent a court order a TPLF funder may avoid adverse costs even if it organised, controlled and financed the unsuccessful lawsuit.

Funders should also be required to agree that control over significant strategic decisions in a lawsuit, such as when to settle and for how much, should be reserved for the claimants. A TPLF investor exerts a significant degree of control over a case because the TPLF funding agreement typically confers wide-ranging contractual discretion on the TPLF investor. A legislative requirement that a TPLF investor must give an undertaking not to exert control over decision-making in the litigation, and a legislative requirement to include such an undertaking in the funding agreement, would promote a greater regard for the claimants, who are the ultimate beneficiaries, to act appropriately and in their best interests.

2. PROVISIONS RELATING TO TPLF INVESTORS' CONDUCT IN CASES

(a) Requirement that a Representative Claimant Instruct Lawyers

After the High Court's decision in *Fostif*, TPLF investors have been able to instruct law firms directly. This is especially problematic in class actions, where individual claimants are not significantly involved in directing the litigation. Without challenging Australia's policy behind permitting TPLF investors to solicit claimants and select lawyers, ILR is concerned that permitting TPLF investors to instruct lawyers on an ongoing basis leads to higher costs and delayed case resolutions. As noted above, Australian TPLF agreements typically grant the investor a greater share of any award the longer the case remains pending. This incentivises TPLF investors to prefer drawn-out cases, even though such cases result in higher costs for defendants (and for losing claimants) and waste scarce judicial resources. For this reason, once a lawsuit is commenced, legislation should prohibit TPLF investors from further instructing the lawyers.

The legislation should further provide that in class actions, the court will appoint a claimant from the class to serve as a representative to the lawyers. This would prevent TPLF investors influencing the claimant they have chosen and thereby prevent the TPLF investors from indirectly controlling the instructions given to the lawyers about the conduct of the case, so that the claimants' interests do not become subservient to the TPLF investors' interests.

(b) Disclosure Requirements

Currently, *Corporations Amendment Regulation 2012 (No. 6)* exempts litigation funders from the disclosure obligations applicable to AFSL licensees. To protect consumers, legislation should provide that, in each case, the TPLF investor must disclose to the claimants:

(i) The fees payable to the investor;

(ii) The obligations and rights of the investor, especially the level of control over decision-making in the litigation and termination rights;

(iii) The obligations and rights of lawyers;

(iv) The obligations and rights of claimants; and

(v) An estimate of costs.

(c) Fiduciary Duties

Legislation should provide that TPLF investors have a non-waivable fiduciary duty to act in the best interests of claimants. Fiduciary obligations create a standard of undivided loyalty characterised by a number of duties, including the duty to:

(i) Avoid conflicts of interest;

(ii) Avoid unauthorised profit from the fiduciary relationship;

(iii) Act in good faith; and

(iv) Act in the client's interests and not one's own benefit.

The desirability of a fiduciary relationship between the TPLF investor and claimants that is imposed by legislation arises from the significant degree of control the funder exerts over the litigation, which also underpins the need for an express statutory undertaking not to exert undue control of the lawsuit as discussed above. The role of a TPLF funder mirrors that of a law firm, because the funder chooses which cases to fund, which claimants to support, which lawyers to engage and what litigation strategy to deploy. The claimant is effectively handing control over to the funder who holds economic power over the funding of the litigation. An overriding clause requiring the TPLF funder to act in the best interests of the claimants seeks to ensure that decisions about the litigation are made properly on a case-by-case basis (including whether a claim is worth filing or not, the ongoing conduct of the case and potential settlement of the dispute) to protect the claimants' interests, and not driven by the imperatives of the funder's funding model based on the present value of their expected return.[34]

(d) Prohibition on Conflicts of Interest

As discussed above, TPLF investments can lead to substantial conflicts of interest among TPLF investors, lawyers and claimants.[35] Senator George Brandis recently acknowledged the real potential for conflicts of interest in TPLF-funded litigation, saying, "I am not satisfied that the existing unregulated system sufficiently addresses the conflicts of interest and moral hazards of, in particular, the litigation solicitors who have a very significant interest in this litigation."[36] Given the risks that these conflicts pose

for consumers—and for the sound and impartial administration of justice—ILR believes that legislation should provide that TPLF investors must avoid conflicts, not simply manage them. Currently, *Corporations Amendment Regulation 2012 (No. 6)* does not mandate conflict avoidance but instead provides that regulations may require a TPLF investor to "have arrangements, and follow certain procedures, for managing conflicts of interest in relation to the scheme."

In April 2013, the Australian Securities and Investments Commission ("ASIC") released its Regulatory Guide 248 "Litigation schemes and proof of debt schemes: Managing conflicts of interest" designed to supplement *Corporations Amendment Regulation 2012 (No. 6)* and articulate ASIC's expectations about maintaining adequate conflict management procedures. Conflicts of interest between the funder, lawyers and claimants may arise in a litigation funding scheme where there is a pre-existing legal or commercial relationship between the funder, lawyers and claimants. The Regulatory Guide states that "[w]hile you must take responsibility for determining your own approach to managing interests that conflict, in our view, if your arrangements are not consistent with the guidance and expectations in this guide, you are less likely to be complying with the obligation and will be exposed to a greater risk of regulatory action."[37]

If, as some have asserted,[38] the role of TPLF investors mirrors the role of lawyers by virtue of the significant degree of control they exert over, and their intimate involvement in, the litigation, it would be incongruous for TPLF investors simply to manage rather than avoid conflicts of interest. A prohibition on conflicts of interest in the TPLF context would also be a necessary consequence of a fiduciary relationship between the TPLF investor and claimants if such a relationship is imposed by legislation.

C. Court and Other Rules

1. TPLF PROVIDER JOINTLY AND SEVERALLY LIABLE FOR ALL COSTS AWARDED AGAINST THE CLAIMANT

In *Jeffery & Katauskas Pty Limited v. Rickard Constructions Pty Limited*,[39] the High Court held that a lower court "did not have the power to make a costs order against a company which was not a party to litigation merely because the company had, for commercial gain, funded litigation by an insolvent plaintiff without indemnifying the plaintiff against an adverse costs order."[40] As a result of the High Court's decision, the defendant was denied reimbursement of its legal fees, even though it had been successful in the underlying litigation, because the claimant was insolvent.

Jeffery's result is not fair—TPLF investors make litigation possible by investing in it, and they should be responsible for any adverse consequences of their investment decisions.

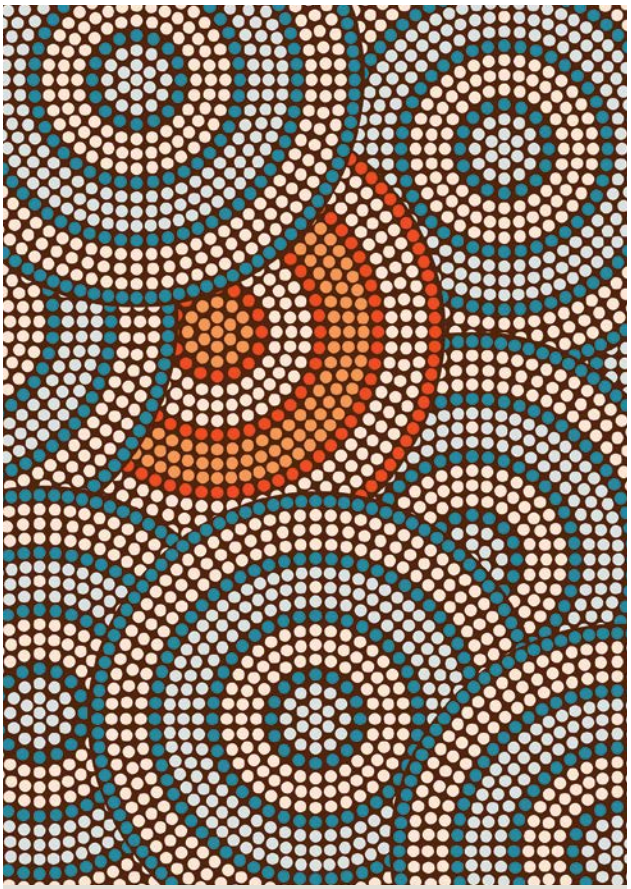
At present, there is no legislative obligation at the Commonwealth or state levels imposed on TPLF investors to assume the risk of meeting an adverse costs order jointly and severally. The court rules at the Commonwealth and state levels provide only limited relief because a costs order against a non-party (such as a litigation

funder) will depend on the exercise of the court's discretion.[41]

Accordingly, the Commonwealth and state governments and/or courts should require that, in the event that a claimant whose case is funded by TPLF investors has an adverse costs order entered against it, the TPLF investors should be jointly and severally liable with the claimant for satisfying the cost award. Moreover, this obligation should not be limited to the amount of the investors' investment in the litigation.

2. PROHIBITION ON PRACTICE OF LAW

The significant control typically exercised by TPLF investors over the litigation they fund could also be viewed as tantamount to the practice of law.[42] Commonwealth and state legislation or court rule amendments are required to clarify that TPLF investors may not engage in actions that are tantamount to the practice of law without the appropriate professional licensing applicable to all lawyers.[43] The amendments should also clarify that persons who engage in TPLF may not be permitted to hold themselves out to the public as lawyers for hire.



"TPLF investors make litigation possible by investing in it, and they should be responsible for any adverse consequences of their investment decisions."

–Lisa A. Rickard
President, U.S. Chamber Institute for Legal Reform

Conclusion

Australia's courts and legislatures have made the policy decisions to embrace pervasive third-party investments in litigation. But now, having done so, strict oversight of those investments is necessary to protect consumers, claimants, businesses and all stakeholders in the sound administration of civil justice in Australia. Prior to the High Court's decision in *Fostif*, the issue of whether and to what degree oversight of TPLF investors is necessary was closely considered by the Standing Committee of Attorneys General and others. Now, more than ever, this issue should be at the forefront of policy debate in Australia. For the reasons described above, a Commonwealth oversight regime that implements the safeguards described in this paper is necessary.

About the U.S. Chamber Institute for Legal Reform

ILR is a not-for-profit public-advocacy organisation affiliated with the U.S. Chamber of Commerce, 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 restore balance, ensure justice, and maintain integrity within the civil legal system. Since ILR's founding in 1998, it has worked diligently to limit the incidence of litigation abuse in courts around the world and has participated actively in legal reform efforts in the United States and abroad.

As part of its core mission, ILR has been studying the effects of TPLF for several years. It has sponsored several nonpartisan symposia and conferences, and has released articles on the effects of TPLF in the United States and in Europe. ILR also has engaged in public advocacy with several state legislatures in the United States, and has been consulted by the governments of European countries and the European Commission regarding TPLF. Recently, ILR submitted comments on the Australian Treasury's consultation draft of the Corporations Amendment Regulations 2012.

Because many of ILR's members have substantial business activities in Australia, ILR is deeply invested in the orderly administration of justice in Australia and in the evolution of Australian legal regimes. ILR submits this proposed oversight regime to protect its constituents, as well as all stakeholders in the civil justice system, from individual consumers to the largest multinationals.

Appendix A—Options for Oversight Agencies

OPTION 1

One option would be for Parliament to empower the Australian Securities and Investments Commission ("ASIC") to oversee the TPLF industry. This can be achieved through amendments to the existing *Corporations Act* 2001 (Cth) and the *Corporations Regulations* 2001 (Cth) under section 798G of the *Corporations Act* 2001 (Cth). ASIC is an appropriate enforcement body given its experience with financial services industries and understanding the problems arising within that setting. TPLF in Australia is, at its core, a financial service, making ASIC the proper regulator for TPLF. In connection with appointing ASIC as the agency to oversee TPLF investments, ASIC would be given the authority to licence TPLF investors and to enforce its rules and any laws and regulations governing TPLF investments.

OPTION 2

The Australian Competition and Consumer Com Commission ("ACCC") could also be authorised to oversee the TPLF industry. The ACCC is the government agency which administers the Australian Competition and Consumer Act. It exercises its statutory powers and functions to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection. The ACCC's obligations include:

- investigating possible breaches of the competition and consumer protection provisions and, where appropriate, bringing enforcement proceedings and obtaining compensation or redress;
- considering applications for immunity from the competition law on a range of public interest grounds; and
- arbitrating disputes over access to essential facilities and in the telecommunications industry.

The ACCC's focus on consumer protection arguably would qualify it to undertake the type of protection for users of the TPLF funding service (claimants to lawsuits) that is so conspicuously lacking at present.

However, the ACCC may not be a suitable agency to be allocated responsibility for oversight over TPLF, since the statutory regime for which the ACCC is responsible does not involve the administration and enforcement of a licensing regime like the AFSL regime under the Corporations Act. Additionally, given that TPLF falls broadly within the category of financial services, ASIC would appear to be the more suitable oversight agency because, unlike the ACCC, ASIC is responsible for the regulation of financial services and financial products.

OPTION 3

Another possibility could be to regulate TPLF investors under the various state regimes governing the legal profession. However, TPLF companies are first and foremost providers of financial services and should not be engaged in the provision of legal services. As such, oversight would more properly reside with an independent statutory body with expertise in financial service regulation. Moreover, in the absence of a uniform national scheme regulating the legal profession, leaving oversight to the state bodies would be unlikely to result in a uniform approach. The result instead could be to encourage forum shopping by TPLF investors.

Appendix B—Options for an Oversight Regime

OPTION 1 - NEW LICENCE

1. This option would involve the implementation of a new legislative regime specific to TPLF schemes. Where implemented the new regime could require TPLF scheme operators (and any persons involved in providing relevant services in respect of TPLF schemes) to be covered by a specific licence which could include appropriate conditions.

2. This approach would be similar to the relatively recent evolution of "credit", which is now regulated by the National Consumer Credit Protection Act 2009 (Cth) and corresponding regulations and where an entity that engages in providing "credit activities" must be covered by an Australian credit licence. It is worth noting here that the Australian credit licence regime is based very heavily upon the AFSL regime.

OPTION 2 - NEW "FINANCIAL PRODUCT"

3. This option involves specifically including TPLF schemes as a "financial product" under Division 3 of Chapter 7 of the Corporations Act. This would require persons who provide "financial services" in respect of TPLF schemes to be covered by an AFSL and to otherwise comply with the existing AFSL framework and obligations. There would of course also be an opportunity to seek appropriate additional obligations for TPLF scheme operators (which, for instance, would not otherwise apply to financial service providers).

4. A similar approach was taken recently with respect to "margin lending facilities" which were added as "financial products" together with a new "responsible lending regime" which imposed additional obligations upon margin loan providers.

OPTION 3 - NEW CLASS ORDER

5. This option involves the introduction of a regime for TPLF schemes through a new ASIC Class Order. The new Class Order could seek to regulate TPLF schemes in the same manner as contemplated by Option 2 (that is, treat TPLF schemes as "financial products" and so require TPLF scheme operators and related participants to be covered by an AFSL).

6. This approach is similar to the existing regulation by ASIC of both "managed discretionary accounts" and "platforms". This approach is generally taken in respect of new or novel "financial products" where the application of the existing financial services regime would be inappropriate and allows for the existing regime to apply in part and new bespoke obligations also to apply.

OPTION 4 - EXPANDED REGULATIONS

7. This option involves amending the existing *Corporations Amendment Regulation 2012 (No. 6)* (which commences on 12 July 2013) so as to include, for instance, additional obligations and/or to reduce the breadth of the exemptions currently afforded to TPLF schemes.

END NOTES

1 (2006) 229 CLR 386.

2 *Id.* at 488.

3 See V Morabito, "An Empirical Study of Australia's Class Action Regimes", Second Report, September 2010, at pages 5 and 37-44; King & Wood Mallesons, Class Actions in Australia, The Year in Review 2012, at 10-11.

4 *See* King & Wood Mallesons, supra note 3 at 10-11.

5 Regulatory Guide 248, "Litigation schemes and proof of debt schemes: Managing conflicts of interest."

6 Senator George Brandis recently noted this trend, stating:

"In view of the decisions of the High Court in 2006 and last year, and most particularly the Chameleon Mining decision, where the court held that litigation funders did not require an Australian financial services licence, it is my view, and the Coalition's view, that this is an area which should be carefully examined with a view to determining whether there is sufficient protection of parties, potential defendants, who may be the subject of opportunist claims. That consideration, plus the broader social consideration of the undesirability of fostering a litigious climate resembling that of the US, persuades me that greater regulation of litigation funding of class actions should be examined.'' Chris Merritt, "Brandis Takes Aim at Litigation Funders," *The Australian*, 19 July 2013.

7 Senator George Brandis stated:

"This is an area ripe for abuse and the government has let the grass grow under its feet in not identifying and anticipating the extent to which abuses and opportunistic claims are being brought. … If elected … a Coalition government would review the regulation of litigation funders and examine whether they should continue to be exempted from mandatory licensing.'' Id.

8 *See supra note 5 at 390, 413, 424; IMF (Australia) Ltd, About Us, available at www.imf.com.au/about.asp.*

9 Greg Houston, Svetlana Starykh, Astrid Dahl, and Shane Anderson, *Trends in Australian Securities Class Actions: 1 January 1993 – 31 December 2009*, (NERA Economic Research Associates, Inc., 2010), at 2.

10 "Class action growth due to funding availability: IMF Australia," *Business Spectator* (June 29, 2010), *available at* www.businessspectator.com.au/bs.nsf/Article/Class-action-growth-due-to-funding-availability-IM-pd20100629-6VHNW?OpenDocument&src=mp.

11 *See generally* Paul H. Rubin, *On the Efficiency of Increasing Litigation*, paper presented to the Public Policy Roundtable on Third Party Financing of Litigation, Northwestern University Searle Center on Law, Regulation, and Economic Growth (Sept. 24, 2009).

12 The Ecuadorian trial court awarded $9 billion in damages to the claimants, which would be doubled if Chevron did not publicly apologise to them. Chevron did not apologise, and the damages were doubled to $18 billion. This judgment is on appeal.

13 *See Chevron Corp. v. Donziger*, Case No. 11-cv-0691 (S.D.N.Y. Mar. 7, 2011), Opinion at 82-83. The Second Circuit later vacated Judge Kaplan's injunction on jurisdictional and procedural grounds, but his factual findings stand. On the Lago Agrio suit, *see generally* Roger Parloff, *Have You Got a Piece of this Lawsuit? The Bitter Environmental Suit Against Chevron in Ecuador Opens a Window on a Troubling New Business: Speculating in Court Cases*, Vol. 163, Issue 8 (June 13, 2011), at 68.

14 *See In re Chevron Corp.*, No. 10-MC-21 (J/LFG) (D.N.M. Sept. 13, 2010) (finding "that . . . discussions trigger the crime-fraud exception, because they relate to corruption of the judicial process, the preparation of fraudulent reports, the fabrication of evidence, and the preparation of the purported expert reports by the attorneys and their consultants."); *In re Application of Chevron Corp.*, No. 10-cv-1146-IEG (Wmc) (S.D. Cal. Sept. 10, 2010) (crime-fraud exception applies because "[t]here is ample evidence in the record that the Ecuadorian Plaintiffs secretly provided information to Mr. Cabrera, who was supposedly a neutral court-appointed expert, and colluded with Mr. Cabrera to make it look like the opinions were his own."); *Chevron Corp. v. Champ*, No. 1:10-mc-0027 (GCM-DLH) (W.D.N.C. Aug. 30, 2010) ("While this court is unfamiliar with the practices of the Ecuadorian judicial system, the court must believe that the concept of fraud is universal, and that what has blatantly occurred in this matter would in fact be considered fraud by any court. If such conduct does not amount to fraud in a particular country, then that country has larger problems than an oil spill."); *In re Application of Chevron Corp.*, Civil Action No, 10-2675 (SRC) (D.N.J. June 11, 2010) Hrg. Tr. at 44 ("In short, the provision of materials and information by consultants on the litigation team of the Lago Agrio plaintiffs in what appears to be a secret and an undisclosed aid of a supposedly neutral court-appointed expert in this Court's view constitutes a prima facie demonstration of a fraud on the tribunal.").

15 *See* Chevron v. Republic of Ecuador, PCA Case No. 2009-23, Second Interim Award on Interim Measures (Feb. 16, 2012), at 3.

16 According to a December 2011 press release, as a result of "[f]urther developments," Burford "conclude[d] that no further financing w[ould] be provided" in the Lago Agrio case. *See* Press Release, Burford Capital Limited, Burford Reports Continued Activity and Entry into UK Market (Dec. 12, 2011), *available at:* http://www.burfordfinance.com/pressroom/press-releases. In January 2013, Burford released a letter it had sent to the Lago Agrio claimants' counsel in September 2011 accusing counsel of defrauding Burford into investing in the litigation. *See* Burford Group to Purrington Moody Weil LLP, Sept. 29, 2011, *available at* http://lettersblogatory.com/wp-content/uploads/2013/01/Burford.pdf.

17 Anne Urda, *Legal Funding Gains Steam But Doubts Linger*, Law360 (Aug. 27, 2008) (quoting a Huron Consulting Group Vice President as saying, "clients may have to relinquish some decision-making authority to the funder" and "the client's interests may diverge from the funder").

18 (2008) 253 ALR 65.

19 *See* Rancman v. Interim Settlement Funding Corp., 789 N.E.2d 217, 220-21 (Ohio 2003) (noting that the amount the plaintiff-appellant owed to litigation financiers was an "absolute disincentive" to settle at a lesser amount).

20 Daniel Chen, *A Market for Justice: A First Empirical Look at Third Party Litigation Funding* (January 2012), at 27, *available at* www.law.upenn.edu/cf/faculty/dabrams/workingpapers/MarketforJustice.pdf.

21 *Id.*

22 Stuart Clark, *After 20 years, action industry finds a class of its own*, *The Australian* (19 July 2013).

23 *See* King & Wood Mallesons, supra note 3 at 5.

24 *See* Goal Group, Recovery Responsibility, a predictive study into securities class actions in legislatures outside the U.S.A., January 2013, at 8.

25 If a claimant wishes to settle the case for less than the TPLF investor considers appropriate or refuses to settle when the TPLF investor considers it appropriate, some TPLF agreements require the claimant and the TPLF investor to seek senior counsel's advice on whether the terms of the settlement are reasonable in all the circumstances.

26 *See also* Campbells Cash and Carry Pty Ltd *v.* Fostif Pty Ltd (2006) 229 CLR 386 at [87] and [93].

27 See Appendix A.

28 The Australian courts have taken different views on the characterisation of TPLF in Australia, including that TPLF may be a "managed investment scheme" (*Brookfield Multiplex Ltd v. International Litigation Funding Partners Pte Ltd* [2009] FCAFC 147) or a "financial product" (*International Litigation Funding Partners Pte Ltd v. Chameleon Mining NL* [2011] NSWCA 50) (i.e. "a facility for managing a financial risk") under the Australian Corporations Act 2001 and a "credit facility" (*International Litigation Funding Partners Pte Ltd v. Chameleon Mining NL* [2012] HCA 45) under the Australian National Consumer Credit Protection Act 2009 but not a financial product under the Corporations Act 2001. In the wake of these differing views, recent regulatory and legislative changes have clarified that TPLF is exempt from being a "managed investment scheme", a "financial product" or a "credit facility" and that litigation funders are not required to hold an Australian financial services licence.

29 For example, *see* Revised Professional Conduct and Practice Rules 1995 (NSW), Statement of Principle.

30 Revised Professional Conduct and Practice Rules 1995 (NSW), rule 10.2. In describing the key elements of a fiduciary relationship, Justice Mason stated in *Hospital Products Ltd v. United States Surgical Corp* (1984) 156 CLR 41:

- "The critical feature of these [fiduciary] relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position." 156 CLR 41 at 96-97.
- "The fiduciary's duty may be more accurately expressed by saying that he is under an obligation not to promote his personal interest by making or pursuing a gain in circumstances in which there is a conflict or a real or substantial possibility of a conflict between his personal interests and those of the persons whom he is bound to protect" 156 CLR 41 at 103.

In the context of a solicitor's obligation, in *McCann v Switzerland Insurance Australia Ltd* [2000] HCA 65 at [16], Gleeson CJ said:

The principle that a solicitor "shall not be permitted to make a gain for himself at the expense of his client" was said by the Lord Chancellor, Lord Westbury, in Tyrrell v. Bank of London, to be one strictly requiring a faithful and honourable observance. In *Law Society of NSW v. Harvey the Court of Appeal of New South Wales* observed that an appreciation of a solicitor's duty not to prefer his or her interest to that of the client rests, not upon some technical instruction, but upon understanding and applying the ordinary concepts of fair dealing.

31 Chief Justice Allsop of the Federal Court of Australia recently queried whether an application by a new litigation funder to share in potential damages from a horse flu class action was a "money- spinner" for the lawyers behind the funder. Senior lawyers from the claimants' law firm reportedly set up the funder to partly finance the litigation the firm was running. *See* "Judge probes lawyers' horse flu damages case" Australian Financial Review July 2013, at 32. Currently, if a legal practitioner engages in TPLF, the legal practitioner must comply with the existing professional obligations under the Professional Conduct Rules in each State. These are designed to ensure that their interests or the interests of the law practice do not conflict with the interests of clients and that engaging in any other business not directly associated with the legal practice is not likely to impair their duties to their clients in the conduct of legal practice. These obligations also apply to legal practitioners who are officers or employees of an incorporated legal practice or a multi-disciplinary partnership that also provides services other than legal services. A legal practitioner must not, in any dealings with a client: (a) allow the interests of the practitioner or an associate of the practitioner to conflict with those of the client; and (b) exercise any undue influence intended to dispose the client to benefit the practitioner in excess of the practitioner's fair remuneration for the legal services provided to the client. *See*, e.g., Revised Professional Conduct and Practice Rules 1995 (NSW) rules 10.1 and 37.1.

32 *See* Corporations Act *(2001)* § 912D. ILR does not believe, however, that failure to report a breach of the TPLF oversight regime should constitute a criminal offense.

33 The Practice Notes in some Australian courts also provide for an obligation to disclose at the early stages of the case (including at the initial case management conference) any agreement as part of the overall TPLF agreement by which a litigation funder is to pay or contribute to the costs of the litigation or any adverse costs order. This requirement provides greater transparency and certainty about the contents of the litigation funding arrangements, but does not ensure that TPLF agreements contain the necessary indemnity to protect the claimant against a successful defendant's costs.

34 Australian judges have recognised the potential for conflicts including in *Campbell Cash and Carry Pty Ltd v. Fostif Pty Ltd,* 229 CLR 386 (2006). While finding TPLF to be lawful, Gummow, Hayne and Crennan JJ considered a range of factors including the following: (i) the funder's act of seeking out of claimants was described as "officious intermeddling"; (ii) there was the degree of control which the funder would have over the proceedings where the litigants' interests were said to be "subservient" to those of the "intermeddler" and (iii) the funder's retainer of a solicitor to act for the plaintiffs and represented parties was said not to lessen the funder's control of the proceedings but to give rise to possible conflicts of duty for the solicitor. *See* 229 CLR 386 at [93] 433. Callinan J and Heydon J specifically pointed to some of the more compelling reasons for fiduciary obligations on litigation funders in their joint statement:

"Normal litigation is fought between parties represented by solicitors and counsel. Solicitors and counsel owe duties of care and to some extent fiduciary duties to their clients, and they owe ethical duties to the courts. They can readily be controlled, not only by professional associations but by the court. The court is in a position to deploy, speedily and decisively, condign and heavy sanctions against practitioners in breach of ethical rules. The appearance of solicitors is recorded on the court file. Institutions like [litigation funders] Firmstone & Feil, which are not solicitors and employ no lawyers with a practising certificate, do not owe the same ethical duties. No solicitor could ethically have conducted the advertising campaign which Firmstone & Feil got Horwath to conduct. The basis on which Firmstone & Feil are proposing to charge is not lawfully available to solicitors. Further, organisations like Firmstone & Feil play more shadowy roles than lawyers. Their role is not revealed on the court file. Their appearance is not announced in open court. No doubt sanctions for contempt of court and abuse of process are available against them in the long run, but with much less speed and facility than is the case with legal practitioners. In short, the court is in a position to supervise litigation conducted by persons who are parties to it; it is less easy to supervise litigation, one side of which is conducted by a party, while on the other side there are only nominal parties, the true controller of that side of the case being beyond the court's direct control." (*See* 229 CLR 386 at [266] 487)

35 Michael Legg has closely studied the problem of conflicts of interest for lawyers arising out of funding arrangements. Among his conclusions:

"The litigation funder is able to exert influence on the lawyer, even if they are not the lawyer's client. Equally the lawyer has incentives to ensure that the funder is satisfied with the lawyer's performance. This combination of influence and incentives may give rise to a conflict of interest for the lawyer." According to Professor Legg, the potential areas of conflict include: the terms of the funding agreement; litigation strategy; termination of the funding agreement; and acting in other litigation funded by the same litigation funder."

Michael Legg, *Litigation Funding in Australia Identifying and Addressing Conflicts of Interest for Lawyers* 29 (U.S. Chamber Institute for Legal Reform 2012).

36 *Brandis Takes Aim at Litigation Funders*, The Australian, July 2013.

37 ASIC RG [248.22].

38 *See* note 34 supra.

39 [2009] HCA 43.

40 High Court of Australia, Manager, Public Information, *Jeffery & Katauskas Pty Ltd v. SST Consulting Pty Ltd & Ors*, 13 Oct., 2009, *available at* www.hcourt.gov.au/assets/publications/judgment-summaries/2009/hca43-2009-10-13.pdf.

41 For example, see Civil Procedure Act (NSW) § 98 (2005) and Federal Court of Australia Act § 43 (1976).

42 *See also Campbells Cash and Carry Pty Ltd v. Fostif Pty Ltd* 229 CLR 386 at § 87, 93, 266 (2006) in relation to the control exercised by TPLF funders; The Regulation of Third Party Litigation Funding in Australia - Discussion Paper, The Office of the NSW Legal Services Commissioner, 2012.

43 Currently, the legal profession and the practice of law are regulated by the Legal Profession Act and the Professional Conduct and Practice Rules in each State. There are strict rules and regulations about eligibility and certification to engage in the practice of law and the requirements pertaining to the conduct of a legal practice.

U.S. CHAMBER
Institute for Legal Reform

202.463.5724 main
202.463.5302 fax
1615 H Street, NW
Washington, DC 20062
instituteforlegalreform.com