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Productivity Commission Issues Paper: Access to Justice Arrangements

Submission from the U.S. Chamber Institute for Legal Reform

The information that follows is largely drawn from two recently released reports issued by the U.S. Chamber Institute for Legal Reform ("ILR") entitled "Third Party Litigation Financing in Australia – Class Actions, Conflicts and Controversy" and "Improving the Environment for Business in Australia – A Proposal for Oversight of Litigation Funding." Both of these reports are attached to this submission in Appendices I and II.

Introduction

The U.S. Chamber Institute for Legal Reform ("ILR") is pleased to submit this response to the Productivity Commission's Issues Paper *Access to Justice Arrangements* ("Issues Paper"). ILR is a not-for-profit public advocacy organization 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. ILR does this by creating broad awareness of the impact of litigation on society and by championing common sense legal reforms at the state, federal, and global levels.

As part of its core mission, ILR has been studying the effects of third party litigation funding ("TPLF") for several years. It has sponsored several nonpartisan symposia and conferences, and has released publications 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 and on the Australian Securities and Investments Commission's *Consultation Paper 185: Litigations schemes and proof of debt schemes: Managing conflicts of interest.*

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. Attached in the Appendix to this submission is a copy of an October 2013 paper entitled "Third Party Litigation Financing in Australia – Class Actions, Conflicts and Controversy" ("ILR TPLF Research Paper") which describes the limitations of TPLF in promoting access to justice and the key problems the TPLF industry poses to the administration of justice in Australia.

Given these issues, ILR has proposed a regulatory regime in Australia to protect its constituents, as well as all stakeholders in the civil justice system, ranging from individual consumers to the largest multinationals. Also attached in the Appendix to this submission is a copy of a September 2013 paper entitled "Improving the Environment for Business in Australia – A Proposal for Oversight of Litigation Funding" ("ILR Oversight Proposal"), which outlines the regime that ILR proposes. Both the ILR TPLF Research Paper and the ILR Oversight Proposal elaborate on ILR's responses (below) to questions posed by the Productivity Commission in its Issues Paper and are integral to this submission.

The Productivity Commission's Terms of Reference

In its Issues Paper, the Commission indicates that it has been requested to examine the current costs of accessing justice services and securing legal representation, and the impact of these costs on access to, and quality of, justice. The Commission has been asked to make recommendations on the best way to improve access to the justice system and equity of representation including, but not limited to, the funding of legal assistance services. The Commission is to regard various factors and considerations including "alternative mechanisms to improve equity and access to justice and achieve lower cost civil dispute resolution, in both metropolitan areas and regional and remote communities, and the costs and benefits of these." This includes analysis of the extent to which litigation funding and other mechanisms "could contribute to addressing cost pressures." [1]

With regards to litigation funding, the Commission poses the following specific questions:

What risks are posed by litigation funding arrangements and how do these differ from the risks posed by contingent and other billing practices? What proportionate and targeted regulatory responses are required to manage these risks and is more uniform regulation required across jurisdictions in this matter?

What are the benefits of litigation funding? In what areas of civil justice is it appropriate to consider use of litigation funding?

Is the availability of litigation funding encouraging a growth in the amount of litigation in some sectors, with a consequent adverse impact on access to justice for other litigants?

Is there evidence that firms are settling more cases due to the availability of litigation funding?[2]

Background

Prior to addressing these very important questions, it would be useful to provide some clarifying information to the Commission with respect to the use of TPLF in Australia.

TPLF Does Not Promote the Objectives Identified by the Productivity Commission

Claims that litigation funding has improved access to justice and equity of representation are overstated. To the contrary, as discussed in the ILR TPLF Research Paper (at pages 7-11) and below, TPLF has served principally as a mechanism to finance specialized types of proceedings to the benefit primarily of the funders themselves and in many instances of large institutional investors. The problems presented by the current unregulated state of affairs (discussed below) far outweigh any perceived benefits in affording increased access to the civil justice system.

Equally serious, the growing use of TPLF has added to the backlog of litigation in Australia and increased the cost of civil dispute resolution. It has encouraged large complex lawsuits, some of which have questionable merit and are only resolved after considerable effort and forced settlement. Again, the principal beneficiaries have been the litigation funders and, increasingly, large institutional investors in securities class action lawsuits. As such, TPLF hardly constitutes an alternative mechanism "to improve equity and access to justice and achieve lower cost civil dispute resolution."[3]

The Nature of TPLF in Australia

In its description of litigation funders, the Commission correctly describes them as "third parties, not related to the dispute, that provide funding for the litigation action in return for a share of the proceeds if the case is successful, while also bearing the financial risks associated with a non-favourable judgment." The Commission also points out that "[m]ost commonly this occurs through a litigation funding company, a commercial entity that contracts with potential litigants, but can be sourced from any individual or organization with sufficient financial resources."[4]

Several other aspects of this most common form of litigation funding should be kept in mind. While it 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 TPLF investor is a specialised investment firm with no other connection to a case that 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 also frequently instruct lawyers (or at least consult with them) regarding litigation strategy, monitor the litigation and participate in settlement negotiations.[5]

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 provider 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 financing 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 favourable 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 decline to pay an adverse cost order, leaving the claimants to foot the bill.[6]

The Use of TPLF in Australia

The Productivity Commission's Issues Paper also states that litigation funding "is not commonplace in Australia and is largely confined to insolvency, commercial cases and class actions." The Issues Paper further notes that "[litigation funding] constitutes less than 0.1 percent of the overall civil litigation market by volume (citing Barker 2011). That said, Australia is considered a pioneer in third-party funding for non-insolvency litigation and litigation funders are exploring opportunities in non-traditional areas."[7]

There is no question that Australia is *the* pioneer in TPLF. Moreover, it is important not to underestimate the extent to which TPLF has encouraged growth in litigation, much of which has had little relation to increased access to justice for those who may need such assistance. 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.[8] 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.[9] 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.[10] This unchecked acceleration in litigation has implications for Australia's civil justice system, cost of doing business and global reputation as an investment destination.

The Lack of Oversight of TPLF

Finally, the Productivity Commission's Issues Paper notes:

> While the courts themselves provide some regulation of litigation funding agreements, there has been relatively little legislative and regulatory guidance from government. Rather than being proactive, it appears the formal regulatory response to the growing importance of litigation funding has been predominantly shaped by legal interpretation and policy reaction.

Not surprisingly, as the Issues Paper points out, "concerns have been raised over the adequacy of litigation funding regulation in relation to addressing conflict of interest issues, consumer protection in the event of default or misconduct, and whether

litigation funders should be required to hold an Australian Financial Services License."[11]

Indeed, the current state of affairs is an anomaly. Although Australian courts have characterised TPLF in different ways, TPLF investors provide a financial service to claimants in the form of financing to conduct litigation. Yet, unlike other financial service providers, TPLF companies—which conduct funding activity and manage financial risk in the context of the risks associated with litigation—operate completely without oversight. This has created a conspicuous gap in the regulatory regime that encourages speculation on litigation in Australia from funding sources around the world with a near total lack of accountability. Given the inherent problems with TPLF, ILR supports the implementation of an appropriate and effective oversight regime.

Questions Posed by the Productivity Commission with Regards to Litigation Funding

Question: *What risks are posed by litigation funding arrangements and how do these differ from the risks posed by contingent and other billing practices? What proportionate and targeted regulatory responses are required to manage these risks and is more uniform regulation required across jurisdictions in this matter?*

ILR Comments:

Risks and Problems with 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. Briefly, they are:

First, TPLF investments increase the volume of litigation pending in the courts, stretching judicial resources and delaying resolutions. TPLF companies view disputes as investments—and they can hedge any "investment" against their entire portfolio of cases. This will make them progressively more willing to invest in cases that are weak on the merits but have at least a chance of a large award. And, as more funders—including from overseas sources—are attracted to the market, competition will provide additional incentive to fund more questionable claims.

In this way, TPLF does have some similarities with contingency fees as used in the United States. 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. However, at least in contingency fee arrangements, the ultimate decision of whether a claim is worth filing sits with a lawyer who is bound by professional rules of conduct and obligations to the Court and the claimant. 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 and no duty to the Court. 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.

Second, by undercutting claimant and lawyer control over litigation and diminishing the role of lawyers in advising claimants, TPLF creates conflicts of interest among claimants, their lawyers and the TPLF investors funding their cases. The conflicts inherent in TPLF are described in more detail in the ILR TPLF Research Paper, pages 15-18. In the class action context, the existence of funding arrangements can actually prejudice non-funded group members by forcing them to share the burden of a funder's premium and can create conflicts of interest between funded and non-funded claimants in the same litigation group. *See* ILR TPLF Research Paper, pages 19-29.

Third, TPLF investments increase the scale and complexity of litigation, may encourage nonmeritorious claims, and can prolong litigation by deterring claimants from settling. *See* ILR TPLF Research Paper, pages 12-14. The TPLF investor is a third party that demands a share of any litigation proceeds. The claimant's obligation to satisfy this extra demand makes reasonable settlement offers less attractive and drives up the cost of funded cases.

These problems caused by TPLF in Australia are also discussed in further detail on pages 5-9 in the ILR Oversight Proposal found in the Appendix to this submission.

Proposed Regulatory Responses

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 litigated 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 a 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.

A more detailed summary of our proposed oversight regime is set forth on pages 9-15 of the ILR Oversight Proposal attached as an Appendix to this submission.

Question 2: *What are the benefits of litigation funding? In what areas of civil justice is it appropriate to consider use of litigation funding?*

ILR Comments: The notion that litigation funding promotes access to justice has long underpinned arguments in TPLF's favor 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. *See* ILR TPLF Research Paper, pages 7-14, for an analysis of the "access to justice" rationale and its limitations. Indeed, in recent years a number of eminent commentators have questioned the extent to which TPLF delivers on this promise.[12]

Question 3: *Is the availability of litigation funding encouraging a growth in the amount of litigation in some sectors, with a consequent adverse impact on access to justice for other litigants?*

ILR Comments:

The very nature of TPLF has resulted in a situation where certain, specific types of claims are funded. 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.[13]

High Financial Thresholds

The financial thresholds in funded cases are high. Funders must be satisfied that the claims they choose to support will generate an adequate return on investment. Typically, these are large scale damages claims. 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.[14] Funders additionally require proof that a prospective defendant will be able to meet a damages award. 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 a funder's criteria.[15]

Restrictive Qualitative Criteria

In addition, funders' 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.[16]

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, products liability or competition legislation.[17] Indeed, as a result of applying these factors, funders have displayed a strong bias towards funding large-scale securities class actions. 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 unable to afford access to justice absent TPLF. And, because of the complexity of securities actions, as well as the large sums involved, these cases have tended to consume significant court resources. 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.[18]

Limited Participation in Actions

Finally, 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.[19] 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 in some cases on actions involving larger class members such as institutional investors and sophisticated corporate customers. Please see the ILR TPLF Research Paper, pages 10-11, for a discussion of these trends.
In sum, a "hands off" approach to the regulation of TPLF has traditionally been justified on access to justice grounds. However, as the ILR TPLF Research Paper demonstrates, recent trends in case selection, class closure and class composition suggest that the additional access provided by TPLF is limited.[20]

Question 4: *Is there evidence that firms are settling more cases due to the availability of litigation funding?*

ILR Comments: While litigation funders' standard arrangements often have the potential to prolong litigation by discouraging early settlements, ultimately the TPLF business model is eventually to force a settlement of the action at the highest practicable return.

The consequences of the funders' forced settlement strategy can be highly undesirable. The Supreme Court of New Zealand recently commented that TPLF "*could exacerbate the risk of defendants begin faced with unmeritorious claims and forced into unjustified settlements.*"[21] This echoes the sentiments expressed in 2009 by Justice Keane. He noted that the case of *Emmanuel & Ors v Fosters*[22] was *"an exemplar of the concern that litigation funding does promote the pursuit of frivolous litigation.*"[23] In that case, Justice Chesterman indicated that *"there was a degree of irresponsibility in the plaintiffs' bringing and prosecuting their actions,"* finding that the proceedings were vexatious and ordered indemnity costs against the plaintiffs.[24]

Conclusion

ILR is grateful for the opportunity to submit comments on the Productivity Commission's Issues Paper. Please do not hesitate to contact us if you have any questions or would like any further information.

Endnotes

[1] Issues paper at iii.-iv.

[2] Issues Paper at 37-38.

[3] *See* ILR TPLF Research Paper at 7-14.

[4] Issues Paper at 37.

[5] Regulatory Guide 248, "Litigation schemes and proof of debt schemes: Managing conflicts of interest" at 390, 413, 424; IMF (Australia) Ltd, *About Us*, *available at* www.imf.com.au/about.asp.

[6] ILR Oversight Proposal at 4.

[7] Issues Paper at 37.

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

[9] *See* King & Wood Mallesons, Class Actions in Australia, The Year in Review 2012, at 5.

[10] *See* Goal Group, Recovery Responsibility, a predictive study into securities class actions in legislatures outside the USA., January 2013 at 8.

[11] Issues Paper at 37.

[12] *See*, for example, Justice Keane, "Access to Justice and Other Shibboleths" (Speech delivered at the Judicial Conference of AustraliaColloquium, 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].

[13] ILR TPLF Research Paper at 7; *see generally* John Walker, Susanna Khouri and Wayne Attrill, "Funding Criteria for Class Actions" (2009) 32 *University of New South Wales Law Journal* 1036.

[14] *Id*.; *see also* John Walker, Susanna Khouri and Wayne Attrill, "Funding Criteria for Class Actions" *supra* note 11, at 1041.

[15] ILR TPLF Research Paper, *supra* note 11, at 8.

[16] *Id.* at 8-9.

[17] *Id*; John Walker, Susanna Khouri and Wayne Attrill, "Funding Criteria for Class Actions" *supra* note 12, at 1040.

[18] ILR TPLF Research Paper, *supra* note 11, at 11.

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

[20] *Id.*

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

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

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

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