

1. Background

- 1.1 In June 2006, the Standing Committee of Attorneys-General (**SCAG**) released a Discussion Paper entitled, "Litigation funding in Australia" (**the Discussion Paper**) which canvassed for opinions from stakeholders on the need for regulation in the emerging market for third-party commercial litigation funding.
- 1.2 Since that time, the High Court's decision in *Campbell's Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386 (**Fostif**) has affirmed the legality of litigation funding as being, essentially, a matter for private contract. It dispensed with the suggestion that the 'intervention' in the litigation process by a commercial stakeholder gave rise to an abuse of process *per se*. Importantly, it did so in a context where the litigation funder in question had taken an extremely prominent role in the litigation to the extent where there was no independent retainer/costs agreement in place between the plaintiffs and the solicitor on the record.
- 1.3 Most recently, the Full Federal Court has handed down its decision in *Brookfield Multiplex Limited v International Litigation Partners Pty Ltd* [2009] FCAFC 147 (**Brookfield Multiplex**), where the Court held that the litigation funding arrangements in that case constituted an unregistered managed investment scheme (**MIS**). Following the decision, ASIC has provided interim relief to participants in existing funded class actions in Australia from the operation of the MIS regime in the Corporations Act. This interim relief will expire on 30 June 2010.
- 1.4 The purpose of this paper is to outline the central areas in which reform is required in relation to litigation funding and to identify and articulate some models through which such reform could be pursued.

2. Executive Summary

- 2.1 Following *Fostif*, a number of issues have been identified as of particular concern:
 - (a) The amount of control a Litigation Funding Company (**LFC**) can wield over funded litigation;
 - (b) Whether LFCs ought to be subject to prudential supervision;
 - (c) Caps on the fees and commissions that can be charged by LFCs.
- 2.2 Slater & Gordon are strong proponents of litigation funding as a means of providing access to justice, and as a tool through which litigants can manage risk in litigation. We strongly agree that regulation is required in order to ensure that LFCs:
 - (a) do not provide legal advice;
 - (b) do not otherwise hold themselves out as lawyers; and
 - (c) act on behalf of clients as if they were lawyers.
- 2.3 IMF (Australia) Limited (**IMF**) strongly argues that they require such control in order to monitor the risk associated with its investment, and threatens a reduction in funding offers (and therefore access to justice) if such scope is not provided. This is a fallacy - as other litigation funders achieve risk management through appropriate contractual arrangements that provide access to documents, litigation budget management and regular reporting from solicitors on record. Further, as a sole purpose business, it is ludicrous to suggest that IMF, as the dominant player in a lucrative market, would simply withdraw as a result of regulatory change designed to increase competition. It is far more probable that the quality and cost of IMF's services would improve.

2.4 With respect, we believe that many of the proposals currently considered by SCAG fail to adequately address the greatest problem in the litigation funding market. That is, the fundamental lack of competition in the litigation funding market. This has led to:

- (a) a near uniformity of available commercial terms; and
- (b) a narrowing in the types of matters in respect of which litigation funding is offered (i.e. a trend towards specialization in for instance, financial product advice claims, as a means of generating efficiencies within the LFC's business.

2.5 We also consider that the *Brookfield Multiplex* decision has the potential to impose a significant practical impediment to class action litigation, which was not intended by the legislature in crafting the MIS regime under the Corps Act. The *Federal Court of Australia Act 1976 (Cth.) (FCA Act)* and State Supreme Court Acts empower the Courts to regulate the conduct of class actions in a manner that will promote access to justice, while preventing abuses of process.

2.6 In our opinion, the package of reforms that ought to be considered are as follows:

Ensuring LFCs do not provide legal services

- (a) In relation to the *Legal Profession Act 2004 (Vic) (LPA)*.
 - (i) expand the definition of e.g. "legal services" in the to ensure that the reservation of legal work under Part 2.2 of the LPA is effective; and
 - (ii) work with State law societies to enforce the Part 2.2 reservation; and/or
- (b) Amend the *Corporations Act 2001 (Cth.) (Corps Act)*:
 - (i) to place specific limits on the role that LFCs are permitted to take in litigation (e.g. the provision of legal services); and
 - (ii) to provide consumer protections (e.g. mandating a separate solicitor/client retainer, and providing statutory remedies that limit an LFCs right of recovery without threatening the indemnity provided to clients).

Abolish the common law prohibition on contingency fees

- (c) Amend the State *Legal Profession Acts* to generally permit lawyers to enter contingency-based costs agreements; or
- (d) Amend the FCA Act to specifically provide that costs be awarded on a contingency basis in relation to proceedings commenced under Part IVA.

Exclude litigation and legal services from MIS regulation

- (e) Amend the Corps Act and LPA (and interstate equivalents) to exclude litigation funding, legal services and incidental matters from the definition of "managed investment scheme." Proposed amendments have been included in the **Schedule**.

3. Litigation Funding Market in Australia

3.1 Only a limited number of LFCs fund commercial litigation in Australia in a non-insolvency context:

- (a) IMF (Australia) Limited (IMF) is the largest litigation funder in Australia, with offices in Sydney, Melbourne and Perth. Its primary focus is on securities class actions (which relate to continuous disclosure breaches by listed companies). It is publicly-listed and raises funds from litigation, and issues of shares and convertible notes. It holds an Australian Financial Services License (AFSL) and, accordingly, is a strong proponent of prudential regulation. It typically charges a commission of 25 to 40% of net litigation proceeds (after reimbursement of costs and disbursements), and also charges 'project management fees,' which are calculated as a 25% uplift on its actual out of pocket expenses.

- (b) international Litigation Funding Partners Inc. (ILFP) is based in Canada, and is funding the *Multiplex* securities class action on similar terms to IMF.
- (c) Comprehensive Legal Funding LLC (CLF) is a US-based litigation funder that has recently entered the Australian market. Its focus is on securities class actions and large financial services claims. It is a private company that operates in Australia with an ARBN. It typically charges a commission of between 25 and 35% of net litigation proceeds and does not charge a project management fee.
- (d) Quantum Litigation Funding Pty Ltd (Quantum) and Litigation Lending Services Pty Ltd (LLS) fund commercial and insolvency litigation relating to smaller commercial disputes where the quantum of loss ranges from about \$1 million. Both Quantum and LLS also charge commissions that range between 25 and 40% of net litigation proceeds. Both Quantum and LLS are privately funded, raising monies from sophisticated investors pursuant to information memorandums.

4. Litigation Funding after *Fostif* and *Brookfield Multiplex*

4.1 Historically, the central challenges to commercial litigation funding have been based on the following doctrines:

- (a) Maintenance: is the improper encouragement of litigation, which was previously a tort and crime in Australia. Closely related are the 'floodgates' arguments that were often raised by defendant lawyers (i.e. that the justice system was already overburdened without third parties with improper motives encouraging litigation that would not otherwise be brought).
- (b) Champerty: is the purchase or funding of litigation by a third party for profit. This was also previously a tort and crime in Australia.

4.2 Defendants would apply to the court of record for a stay of funded proceedings on the grounds that the litigation funding agreement was: a) against public policy; or b) constituted an abuse of process.

Fostif

- (a) In *Fostif*, the defendants argued that the arrangements between the client, lawyer and LFC were problematic because the involvement in private litigation of a third-party with a profit motive was or had the potential to create an abuse of process.
- (b) Gummow, Hayne and Crennan JJ held that:
 - (i) The major role played by an LFC (Firmstone & Feil) did not constitute an abuse of the Court's process, nor was there any public policy reason why the proceeding should be stayed (Gleeson CJ and Kirby J agreed on this point).
 - (ii) The statutory abolition of maintenance and champerty as crimes and torts in NSW specifically preserved only the part of the common law relating to the circumstances in which champertous contracts are to be treated as contrary to public policy or as otherwise illegal. The defendant's contentions concerning the LFC's "trafficking in litigation" or "officious intermeddling" were insufficient to warrant a stay.
 - (iii) The question of whether the terms of a funding agreement were fair is a matter between the LFC and funded client - it is not a matter for the defendant and certainly does not warrant the stay of a proceeding on the defendant's motion.
 - (iv) It was left open for a future court to find that a combination of the subordination of court processes by a funding agreement, or fairness to a funded party, caused an abuse of process, but that would depend on the particular facts and no general rule would apply.
- (c) The minority (Callinan and Heydon JJ) held that the funding agreement constituted an abuse of process.

Brookfield Multiplex

- (d) In 2006, representative proceedings were brought by P Dawson Nominees Pty Ltd (**Dawson**) against Brookfield Multiplex claiming compensation for loss and damage alleged to have been suffered as a result of the respondent's alleged misleading and deceptive conduct and breach of continuous disclosure requirements. In 2008, further representative proceedings were brought by Frederick Hart (Hart) and this proceeding was consolidated with the Dawson proceeding.
- (e) The representative proceedings were brought by Hart and Dawson as a "closed classes" and to be eligible to join the actions individuals were, inter alia, required to execute a legal costs agreement with Maurice Blackburn, the firm with conduct of the proceedings on behalf of the representative applicants, and to execute a funding agreement with ILFP.
- (f) The litigation funding agreement between ILFP and group members was not unusual, and provided that:
 - (i) ILFP would fund disbursements and 75 percent of Maurice Blackburn's costs of the proceeding on behalf of group members and would provide security for the costs of the proceeding;
 - (ii) Group members agreed to assign to ILFP between 25 to 40 percent of any judgment or settlement received;
 - (iii) Maurice Blackburn agreed to provide legal services for the common benefit of the representative applicant and group members in exchange for a fee. The legal cost agreement also provided that 25 percent of Maurice Blackburn's fees would be payable only in the event of a successful outcome.
- (g) Brookfield Multiplex argued that the funding arrangements in the litigation constituted a managed investment scheme for the Corps Act,¹ and was required to be registered with ASIC. In the absence of such registration, Brookfield Multiplex argued that the scheme was illegal and should be stayed.
- (h) In the Full Court, Sundberg and Dowsett JJ overturned the first instance decision of Finkelstein J and held that the litigation funding arrangements before it satisfied the elements of section 9 of the Corporations Act and constituted a managed investment scheme.
- (i) Their Honours further noted that, whilst it was clear that the funding arrangement before them constituted a scheme that was being operated while unregistered, there was some debate as to whether ILFP or Maurice Blackburn was the responsible entity for the purposes of Chapter 5C.
- (j) Justice Jacobsen dissented, holding that the funding arrangement did not involve the necessary element of pooling by group members to produce financial benefits.

4.7 As a result of these cases, it can be said:

- (a) The propriety of litigation funding has been endorsed by the High Court as a matter of principle; and
- (b) There remain practical (if unintended) statutory impediments to litigation funding and class action litigation that require legislative intervention.

¹ Section 9(a) of the Corps Act provides that a managed investment scheme has the following features:

- people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not)
- any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders)
- the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions)

5. Concerns regarding Litigation Funders

Control of Litigation

- 5.1 In *Fostif*, the majority found that the litigation funding agreement in question did not constitute an abuse of process, notwithstanding that:
- (a) the lawyers were retained by the LFC, not the clients; and
 - (b) the LFC was permitted to investigate the claims, instruct in the litigation and settle, without consultation with the clients.
- 5.2 Despite the judgment, there has been considerable concern about LFCs maintaining such a depth of control over proceedings.
- 5.3 In practice, both Slater & Gordon and Maurice Blackburn require that:
- (a) their conduct of the representative proceeding be on the instructions of the representative party to the proceeding (albeit in consultation with the LFC);
 - (b) there be a separate retainer with the client, which outlines the terms on which the lawyer has agreed to act and defines the fiduciary relationship;
 - (c) provides dispute resolution procedures and, where appropriate, committee/consultation structures; and
 - (d) prevent LFCs from driving settlements by requiring:
 - (i) Senior Counsel's advice that the proposed settlement is reasonable; and
 - (ii) the approval of more than 50% of funded clients.
- 5.4 To the extent there may be concern that such protocols will not be followed by less scrupulous LFCs or lawyers, there is little to be lost by implementing reforms that require a solicitor/client retainer as a necessary consumer protection.

Caps on Fees/Commissions

- 5.5 Some concern has been expressed (for instance by ASIC in relation to the Westpoint collapse) about the cost of obtaining litigation funding, which can be up to 40% of net recoveries.
- 5.6 The argument that LFC commissions are excessive is often supported by the presumption that funded clients are often small, unsophisticated investors that are presented with a 'take-it-or-leave-it' choice. This argument fails to consider:
- (a) That many funded clients are institutional investors that value the risk management benefits of litigation funding more than the potential litigation returns that comprise the commission.
 - (b) That the cost of legal services, both as an up-front disbursement as well as a potential adverse costs liability, in most cases warrant a high risk premium. (Contingency fees of 30% are charged by US lawyers, notwithstanding that there is no adverse costs risk in that jurisdiction).
 - (c) That the small investors are usually unable to pay for legal services and are concerned by the risk of adverse costs. Any proposed measure that had the effect of dissuading litigation funding could have a strong negative impact on access to justice.
- 5.7 Slater & Gordon opposes the regulation of LFC commissions in the form of a cap, as this would potentially pose a deterrent on new funders entering the litigation funding market. For instance, a complicated and novel claim against a powerful defendant might receive litigation funding at 50% commission, in circumstances where such causes of action would otherwise not be pursued.

- 5.8 It is our strong position that the most appropriate method of reducing the costs of litigation funding is to support measures that increased competition in the litigation funding market. Only through competition will LFC commissions be reduced, whilst improving the quality of litigation funding services simultaneously.
- 5.9 By way of example, the entry of CLF into the Australian market had an immediate impact on the cost of litigation funding services in Australian securities class actions. For the first time faced with competition, IMF's commission was reduced from a range of 25 to 40% to a range of 15 to 30%, representing a substantial direct potential financial benefit to group members.

Prudential Supervision

- 5.10 IMF is the strongest proponent of the prudential supervision of LFCs. This is because:
- (a) their publicly-listed structure already demands a high level of financial disclosure;
 - (b) they already have an AFSL-license and regard themselves as well placed to
- 5.11 Accordingly, imposing threshold regulatory requirements is strongly in IMF's interest as it will place a significant barrier to entry into the marketplace.
- 5.12 It is understandable that a funded plaintiff might be concerned about a scenario in which their claim is unsuccessful and the litigation funder is unable to meet its contractual obligations to indemnify the plaintiff against an adverse costs order. However, in practice, the capacity of the litigation funder to meet its financial commitments is already adequately dealt with by the rules of all superior courts. Particularly, in class action litigation, the defendants will (almost without exception) apply for an order that the representative party(s) provide security for costs. Such security for costs orders are often sought throughout the litigation as the defendant's legal costs increase, and, where orders are made, paid by the litigation funder in a manner acceptable to the court (usually by letter of credit or guarantee rather than by cash).
- 5.13 The negative impact that prudential supervision would have on competitiveness in the litigation funding market would considerably outweigh the benefits to consumers of legal services.

6. Contingency Fees

- 6.1 In the context of this paper, the term contingency fee will be used to refer to a fee charged for the provision of legal services, the calculation of which is referable to the quantum of damages obtained. Historically, the common law used a much wider definition of contingency fee as a fee charged for the provision of legal services, the payment of which was conditional (in whole or in part) on obtaining a successful outcome on behalf of the client (referred to here as a conditional fee). Accordingly, it is this position that has been abrogated by *Legal Professional Legislation* in most Australian States and Territories, which modify the common law by permitting lawyers to enter into costs agreements that charge conditional fees.
- 6.2 This distinction is important, as it demonstrates that the law must necessarily develop with changing social circumstances.
- 6.3 To the extent that the *Legal Professional Legislation* purports to expressly prohibits contingency fees, it merely does so by restating the common law. Accordingly, removing the prohibition would not render the charging of contingency fees legal *per se*.

- 6.4 The common law position in relation to contingency fees was stated by the High Court in *Clyne v Bar Association (NSW)* (1960) 104 CLR 186:

"...a solicitor may with perfect propriety act for a client who has not means, and expend his own money in payment of counsel's fees and other outgoings, although he has no prospect of being paid either fees or outgoings except by virtue of a judgment or order against the other party to the proceedings.² This, however, is subject to two conditions. One is that he has considered the case and believes that his client has a reasonable cause of action or defence as the case may be. And the other is that he must not in any case bargain with his client for an interest in the subject-matter of litigation, or (what is in substance the same thing) for remuneration proportionate to the amount which may be recovered by his client in a proceeding..."[at 203].

- 6.5 In *Clyne*, the High Court also approved of *Pittman v Prudential Deposit Bank Ltd* (1896) 13 TLR 111, in which Lord Esher MR said, at 111:

"...in order to preserve the honour and honesty of the profession it was a rule of law which the Court had laid down and would always insist upon that a solicitor could not make an arrangement of any kind with his client during the litigation which he was conducting so as to give him any advantage in respect of the result of that litigation. That might be said to be on account of the fiduciary relation between the solicitor and the client. But the doctrine was founded upon a higher rule. The responsibility of persons engaged in the profession of the law was very great, and their conduct must be regulated by the most precise rules of honour. The Court thought that, unless the rule was carried out to its fullest extent, there would be a temptation to solicitors which they should not be subjected to. It was useless to say that in the particular case the solicitor was not tempted and that he acted from the most honourable motives. The law was universal that, without considering the motives of the particular solicitor, a solicitor must not persuade his client, or indeed accept from his client a voluntary offer, so as to obtain any advantage dependent upon the result of the litigation which he was then conducting." [This was approved of in *Wallersteiner v Moir* (No 2) [1975] 1 All ER 849 at 860.]

- 6.6 In *Pitman*, Buckley U said in discussing contingency fees:

"Where...the remuneration which the adviser is to receive is to be, or to be measured by, a proportion of the fund or of the value of the property recovered, the arrangement may fall within that particular class of maintenance called champerty...It may, however, be worthwhile to indicate briefly the nature of the public policy question. It can, I think, be summarised in two statements. First, in litigation, a professional lawyer's role is to advise his client with a clear eye and an unbiased judgment. Secondly, a solicitor retained to conduct litigation is not merely the agent and adviser to his client, but also an officer of the court with a duty to the court to ensure that his client's case, which he must, of course, present and conduct with the utmost care of his client's interests, is also presented and conducted with scrupulous fairness and integrity. A barrister owes similar obligations. A legal adviser who acquires a personal financial interest in the outcome of the litigation may obviously find himself in a situation in which that interest conflicts with those obligations: see in this connection *Neville v London 'Express' Newspaper Ltd* [1919] AC 368, 382-7 and *In re Trepcza Mines Ltd* (No 2) [1963] Ch 199, 219, 255."

- 6.7 We have received advice that the central vice to be complained of is not the potential conflict of interest between the lawyer and the client, but rather the potential for contingency fees to impede a lawyer's primary duty to the court.
- 6.8 This is vastly different to the US perspective, which regards contingency fees as a means of avoiding the equally dubious situation in which time-costing lawyers perform unnecessary work for their clients (thereby adding to delays in the court system). The view is that, if a lawyer is going to get a fixed proportion of damages from the resolution of a claim, then the best way of aligning that lawyer's interest with that of the client and the court is by contingency fees, which encourage the largest possible resolution as quickly as possible.

² In *Clyne*, the Court went on at 204-5 to speak approvingly of the decision of Ostler J in *Sievewright v Ward* (1935) NZLR at 48, in which His Honour said that the conduct of a solicitor in risking his or her own money on the pursuit of a claim (assessed as being meritorious) for an impecunious plaintiff was not only legal, but "consistent with the highest professional honour."

- 6.9 In this regard, and in light of the rise of commercial litigation funding, it is worthwhile considering in an Australian context whether this risk remains 'alive' (either generally, or in relation to specific kinds of litigation) or whether it is an anachronism that fails to properly account for the reality of modern litigation:
- 6.10 LFCs are governed only by their contractual duty to the funded client. They do not owe:
- (a) a duty as an officer of the court; and
 - (b) any established fiduciary duty to their client to prefer the client's interests over their own.³
- 6.11 In our view, assuming a 'like for like' provision of services to the client, there is no question that:
- (a) a client would be better protected in a system which allowed lawyers to charge contingency fees in competition with LFCs, because:
 - (i) Lawyers owe ethical duties as officers of the court to ensure the proper administration of justice. This includes the diligent and timely prosecution of cases, as well as an overarching obligation to ensure that the court is properly informed; and
 - (ii) Lawyers owe fiduciary duties to their clients and are therefore unquestionably obliged to prefer their client's interest to their own in the event of any conflict.
 - (b) The cost of providing equivalent services would reduce, because:
 - (i) The contingency fee would encompass both the professional fees charged by the lawyer in respect of the work performed in the litigation, as well as the risk assumed by the lawyer in agreeing to the retainer. (This stands in stark contrast to litigation funding agreements under which, *in addition* to the contingency fee, there is a right of reimbursement for out of pocket expenses (including legal costs) and often a "project management fee").
 - (ii) Within an imposed statutory limit, lawyers would be able to offer comparatively attractive commercial terms to clients, who would not be paying for an additional set of business overheads.

³ Indeed, it is quite possible that a LFC would deny that fiduciary duties were owed (if the issue was ever pressed by a client), given the strictly commercial nature of the risk-sharing transaction being entered into.

SCHEDULE OF PROPOSED AMENDMENTS RELATING TO *BROOKFIELD MULTIPLEX*

Proposed Amendment to the *Corporations Act 2001 (Cth)*

In section 9 of the *Corporations Act*, there is a list of matters that are excluded from the definition of "managed investment scheme" for the purposes of the Act. This list should be amended by inserting the following paragraph:

- (maa) a scheme for participating in, conducting, and/or funding legal proceedings, or involving the provision or funding of services incidental to legal proceedings.
- (mab) a scheme for the provision or funding of legal services.

Proposed Amendment to the *Legal Profession Act 2004 (Vic)*

Current Position

- 2.7.5(2) An incorporated legal practice (or a related body corporate) must not conduct a managed investment scheme.

The note provides that "contravention of this section or these regulations is a ground for banning an incorporated legal practice"
- 1.2.1 "managed investment scheme" has the same meaning as in Chapter 5C of the *Corporations Act*.

Proposed Amendment

- 1.2.1 "managed investment scheme" has the same meaning as in Chapter 5C of the *Corporations Act*, but excludes:
 - (a) a scheme for participating in, conducting, and/or funding legal proceedings, or involving the provision or funding of services incidental to legal proceedings.
 - (b) a scheme for the provision or funding of legal services.