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Supreme and Federal Court Judges Conference

Hobart – January 2009

Policy Issues in Litigation Funding[1]

1. Introduction

Before I move to the substance of my presentation, Policy Issues in Litigation Funding, I think it is important to define the context within which I propose to address these policy issues.

1.1 Insurers are Third Party Litigation Funders

The first contextual matter to note is that claimant funding by Government through Legal Aid and by lawyers through no win, no fee pricing policies will not be addressed.

The focus of this presentation is upon:

(a) claimant funding by commercial litigation funders; and

(b) defendant funding by insurers pursuant to policies of indemnity (for example motor vehicle, product liability, professional indemnity and directors and officers insurance).

I choose to include insurer funding of litigation in the context of third party litigation funding for 2 reasons:

First: the policy issues thrown up by litigation funding, whether the third party is a claimant litigation funder or a defendant funder, are basically the same; and

1 This presentation draws heavily from a paper written by Wayne Attrill, who has returned from Europe after a year of funding cartel claims, entitled "Ethical Issues in Litigation Funding" dated 12 November 2008.

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Secondly: that the common law, fiduciary, ethical and regulatory responses to these issues over the last couple of hundred years in the insurer context are adaptable to claimant litigation funders as the new kids on the block.

The role of insurers and litigation funders enable this comparison in that:

(a) both enter into tripartite contractual relations with the funded client / insured and their lawyers;

(b) both assume day to day responsibility for the provision of instructions to the lawyers with the carriage of the matter;

(c) both pay for the conduct of the litigation; and

(d) both pay any adverse cost orders, although the insurance industry currently considers their liability capped at a limit agreed to with the insured without regard to the costs they cause to the claimant or to the civil justice system.

If only litigation funders had that comfort.

1.2 Access to Justice

The second contextual matter is to address policy considerations concerning litigation funding, through a focus on Access to Justice as has occurred in the United Kingdom.[2]

This is appropriate given that demand for funding results from cost, delay, inequality of arms and risk issues inherent in the adversarial process.

Effective access to the enforcement of rights and delivery of remedies depends on an accessible and effective civil justice system[3]. Indeed, access to justice is now regarded as a fundamental human right which ought to be readily available to all.[4]

Chief Justice Martin recently and energetically noted likely reform when speaking of the Justice System of Western Australia when he said:

2 Legislation was enacted called the Access to Justice Act 1999 (UK).

3 Interim Report to the Lord Chancellor on Civil Justice in England and Wales, Lord Woolf, June 1995 (Chapter 1, paragraph 2).

4 Per Millett LJ in Thai Trading v Taylor [1998] QB 781 at [786].

> "*It is a very good system, the envy of many countries in the world. Every conceivable process is available to ensure that no stone is left unturned in the search for a just resolution. It is the Rolls Royce of justice systems in the sense that it is the best that money, a lot of money, can buy. But there isn't much point in owning a Rolls Royce if you can't afford the fuel to drive it where you want to go. You can polish it, admire it and take pride of ownership from it but it doesn't perform its basic function sitting in the garage…*
>
> *The community owns the justice system of this State but very few of its citizens can afford to engage in its processes. It might be time to consider trading our Rolls Royce for a lighter, more contemporary and more fuel efficient vehicle which we can actually afford to drive and which will get us where we need to go just as effectively and perhaps more quickly."*[5]

Costs, delays and inequality of arms in our adversarial system are at the centre of relevant policy considerations. The high demand for funding is a symptom of the problem, not the cause. Any assessment of public policy ought not lose sight of the detriment to society caused by a civil justice system that for most Australians is inaccessible and thereby incapable of fulfilling its Overriding Purpose.[6]

1.3 The Demand for Claimant Litigation Funding

People determining whether to commence commercial litigation or class actions in Australia are usually confronted with the same risks Lord Woolf identified in 1996 in a report entitled "Access to Justice" when he examined the English and Welsh civil justice system and found it to be:

(a) *too expensive;*

(b) *too slow;*

(c) *too unequal: there being a lack of equity between the powerful, wealthy litigant and the under-resourced litigant;*

(d) *too uncertain: the difficulty of forecasting what litigation will cost and how long it will last induces the fear of the unknown;*

5 Welcome to Honourable Chief Justice Martin, transcript of proceedings, The Supreme Court of Western Australia, 1 May 2006.

6 See for example the Civil Procedure Act 2005 (NSW), Section 56, which identifies the overriding purpose of the Court to achieve just, quick and cheap resolution of the real issues between the parties.

(e) *incomprehensible;*

(f) *too fragmented;*

(g) *too adversarial as cases are run by the parties, not by the courts; and*

(h) *the rules of the court, all too often, are ignored by the parties and not enforced by the court*.

These risks for potential claimants, which I will call "**Litigation Risks**", may be restated as follows:

(a) not being able to obtain an estimated budget from their solicitor, let alone a set fee:

(b) not being able to predict how long the litigation process will take with any degree of certainty;

(c) a pricing policy by the lawyers requiring payment for an indeterminant number of hours worked;

(d) confronting:

i. well resourced defendants with the capacity to obtain the best legal and expert advice; and

ii. legal advice they may find difficult to understand or which does not properly identify the risks, including that the claim may fail, with the result that the claimant will not receive any money by way of judgment, will not receive reimbursement of the legal costs actually paid and will have to pay the other side's costs if their claim is unsuccessful; and

(e) no capacity to predict how much the potential adverse costs order may be in dollar terms or when it might be payable.

As a result of potential claimants' justifiable concerns about the Litigation Risks:

(a) access to justice is difficult, to say the least;

(b) genuine claims may not be prosecuted;

(c) speculative actions are minimised; and

(d) demand for litigation funding is growing and will continue to grow until the Litigation Risks are better managed by the legislature, judiciary and the legal profession.

Revenues of claimant litigation funders have grown from zero 15 years ago to currently about **$50 million** per year.

1.4 The Demand for Defendant Litigation Funding

On the defendant's side of the fence, net premiums paid by potential Australian defendants to obtain indemnities and manage the Litigation Risks are in excess of **$15 billion per year**.
There does not seem, however, to be any qualitative or quantitative data currently available to the Courts or the public in respect of:

First: the proportion of insurance claims by category or in total that require legal proceedings to be commenced before they are resolved;

Second: the proportion of litigated claims where the insurer denies indemnity;

Third: the cost to the claimant, the Court and the insurer of claims resolved after proceedings are commenced;

Fourth: the delays involved in respect of these proceedings; and

Finally: the percentage of defended claims that are resolved by settlement or judgment in favour of the claimant.

In particular, there is no publicly available data identifying what proportion of insurer payouts benefit Australian claimants and what proportion goes in the cost incurred by the general insurance industry in minimising pay outs for the industry's benefit.

In any event, unless the quantum of any claim is greater than the maximum insured amount, the insured has no economic demand for the insurer to defend the action. The risk has been transferred to the insurer who, for all currently relevant purposes, controls the defence to manage its risks in its own interests which in turn may lead to delay and diversion rather than efficient resolution of claims.

This in turn increases the demand for claimant litigation funding.

2 Claimant Litigation Funding in Australia

Claimant litigation funding in Australia, other than by legal aid or by solicitors providing legal services on a "no win, no fee" pricing policy, emanated from the insolvency market and was enabled by the Corporations Act and Bankruptcy Act providing external controllers and trustees in bankruptcy with statutory powers of sale. Since the commencement of insolvency regimes in Australia, insolvency practitioners have exercised their statutory powers of sale to sell a portion of the fruits of their actions in return for funding to conduct litigation. This was seen as an exception to the rules against maintenance and champerty as the Courts would not prohibit that which the legislature permitted.

Accordingly, until 2001, litigation funding was limited to funding for insolvency practitioners.

The basic terms of litigation funding agreements have not changed, nor are they likely to change. In return for a promise to reimburse the funder's investment and to pay a share of the settlement or judgment proceeds if and only if proceeds are received, the funder agrees to investigate the claim and manage and fund the litigation.

In 2001, IMF listed on the Australian Stock Exchange and broadened its funding market to also include:

(a) non insolvency related commercial litigation conducted solely in the Supreme Courts and the Federal Court with claim values over $2 million ("**Commercial Litigation**"); and

(a) multi party commercial claims usually involving breaches of the Corporations Act and Trade Practices Act ("**Class Actions**").

This decision was based upon a belief that considerations of public policy that once found maintenance and champerty repugnant would focus more in the future on the social utility of litigation funding.

3 Maintenance and Champerty

Claimant litigation funding, being a relatively recent development, excites controversy. Historically the common law condemned litigation funding as illegal. This was because it offended the medieval doctrines of "maintenance" and "champerty." Maintenance is the ancient common law crime and tort of assisting a party in litigation without lawful justification and champerty is an aggravated form of maintenance, in which the maintainer receives something of value in return for the assistance given.[7]

Maintenance and champerty were designed to prevent powerful men from misusing the courts by financing civil disputes in which they had no legitimate interest solely for the purpose of harassing and ruining their rivals or enemies. At a time when the powers of the courts were too weak to control such abuses, the Judges imposed a blanket prohibition.

Times have changed. Fifteen years ago the New South Wales Law Reform Commission observed that: *"the considerations of public policy which once found maintenance and champerty so repugnant have changed over the course of time. The social utility of assisted litigation is now recognized and the provision of legal and financial assistance viewed favourably as a means of increasing access to justice."*[8]

Judicial attitudes towards maintenance and champerty are now more relaxed as courts recognise that the evils sought to be controlled by the doctrines are either non existent or are adequately addressed in other ways, which I will address later. Maintenance and champerty have been abolished by statute as crimes and civil wrongs in New South Wales[9], Australian Capital Territory,[10] Victoria,[11] South Australia[12] and in the United Kingdom.[13] Many commentators regard maintenance and champerty today as largely anachronistic and obsolete and, conversely, policymakers in many countries express support for the continued development of litigation funding.

But maintenance and champerty are not dead just yet. Courts can still invalidate a third party funding contract on the grounds that the contract is to be treated as contrary to public policy or

7 NSW Law Reform Commission, Discussion Paper, Barratry Maintenance and Champerty, No 36 (1994) at 7, para 2.7.

8 Ibid at § 2.55.

9 Sec 4 Maintenance, Champerty and Barratry Abolition Act 1993 (NSW)

10 Sec 68 of the Law reform (Miscellaneous Provisions) Act 1995 (ACT) and sec 221 of the Civil Law (Wrongs) Act 2002 (ACT).

11 Sec 322A of the Crimes Act 1958 (VIC) and sec 32 of the Wrongs Act 1958 (VIC).

12 Sub-ss 1(3) and 3(1) of Sch 11 Criminal Law Consolidation Act 1935.

13 Secs 13 and 14 of the Criminal law Act 1967 (UK).

otherwise illegal.[14] Some Judges remain wary of the involvement of litigation funders and strong objections to litigation funding, which carry more than an echo of the ancient abhorrence with champerty, are still heard. Some courts and regulators also fear that litigation funding may lead to undesirable "trafficking" in litigation, the misuse or overuse of court resources, the exploitation of vulnerable litigants, the exposure of defendants to unfair risks and the creation of unacceptable conflicts of interest and ethical dilemmas for the lawyers who are being paid by funders.

Thankfully, most of these issues were addressed by the High Court in 2006.

4 The Fostif Decision

The tensions which exist between the proponents and the critics of litigation funding are well illustrated in the High Court of Australia's seminal 2006 decision in the *Fostif* case.[15] *Fostif* confirmed, by a 5:2 majority, that it is not contrary to public policy under Australian law for a funder to finance *and control* litigation in the expectation of profit. The minority in the High Court, on the other hand, trenchantly criticised the funding arrangement.

The funding agreement at issue in *Fostif* conferred significant powers on the funder, yet it was upheld. In particular, the funder:

- sought out thousands of claimants through an extensive advertising and direct marketing campaign;
- retained the solicitor to act for the claimants and forbid the solicitor from directly liaising with the claimants;
- gave all instructions to the solicitor in relation to the conduct of the proceedings;
- had the power to settle the claims with the defendants (provided the amount of the settlement was not less then 75% of the amount claimed);
- undertook the significant administrative task of identifying and organising the claimants;

14 Refer for example to section 6 of the Maintenance, Champerty and Barratry Abolition Act 1993 (NSW)

15 Campbells Cash and Carry Pty Ltd v Fostif Pty Limited [2006] HCA 41; Gleeson CJ, Gummow, Hayne, Crennan, Kirby, Callinan and Heydon JJ ('Fostif').

- agreed to meet all the legal costs and disbursements of the proceedings, which were ultimately lost in the High Court;

- indemnified the claimants against all adverse costs orders; and

- provided security for the defendants' costs in the sum of $1 million.

In return, the funder:

- would receive up to a third of any amounts recovered by the claimants; and

- would retain any amounts awarded to the claimants for costs.

The Minority Decision

The Judges who were in the minority, Justices Callinan and Heydon, were scathing in their criticism of the funder's arrangements. They articulated the role of third party funders in court proceedings in a manner which I find it difficult to distinguish between a claimant litigation funder's role and an insurer litigation funder's role as follows[16]:

> *"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 but for the efforts of the third parties, by instituting proceedings purportedly to resolve those disputes, by assuming near total control of their conduct, and by manipulating the procedures and orders of the court with the motive, not of resolving the disputes justly, but of making very large profits.*
>
> *Courts are designed to resolve a controversy between two parties who are before the court, dealing directly with each other and with the court: the resolution of a controversy between a party and a non-party is alien to this role. Further, public confidence in, and public perceptions of, the integrity of the legal system are damaged by litigation in which causes of action are treated merely as items to be dealt with commercially."*

16 Fostif at [226] per Callinan and Heydon JJ.

The Majority Decision

The majority Judges (Chief Justice Gleeson and Justices Gummow, Hayne, Crennan and Kirby) took a very different view. Justices Gummow, Hayne and Crennan in a joint judgment said[17]:

> *"Shorn of the terms of disapprobation, the appellants' submissions can be seen to fasten upon Firmstones' seeking out those who may have claims, and offering terms which not only gave Firmstones control of the litigation but also would yield, so Firmstones hoped and expected, a significant profit to Firmstones. But none of these elements, alone or in combination, warrant condemnation as being contrary to public policy or leading to any abuse of process.*
>
> *As President Mason rightly pointed out in the Court of Appeal, many people seek profit from assisting the processes of litigation. That a person who hazards funds in litigation wishes to control the litigation is hardly surprising. That someone seeks out those who may have a claim and excites litigation where otherwise there would be none could be condemned as contrary to public policy only if a general rule against the maintenance of actions were to be adopted. But that approach has long since been abandoned."*

Their Honours went on to consider two fears associated with litigation funding: fears about possible adverse effects on the litigation process and fears about the fairness of the bargain struck between the funder and the client. They concluded that: *"To meet these fears by adopting a rule in either form would take too broad an axe to the problems that may be seen to lie behind the fears"*.[18]

They rejected a role for the courts in assessing whether a funding agreement was "fair" as this assumed, wrongly, that "there is some ascertainable objective standard against which fairness is to be measured and that the courts should exercise some (unidentified) power to relieve persons of full age and capacity from bargains otherwise untainted by infirmity."[19] And in response to Lord Denning's often repeated warning in *In re Trepca Mines Ltd (No 2)*[20] that the *"common law fears that the champertous maintainer might be tempted, for his own personal gain, to inflame damages,*

17 Fostif at [88] – [89] per Gummow, Hayne, Crennan JJ

18 Ibid at [91]

19 Ibid at [92]

20 [1963] Ch199 at 219-220

to suppress evidence, or even to suborn witnesses", the majority replied:[21]

> *Why is that fear not sufficiently addressed by existing doctrines of abuse of process and other procedural and substantive elements of the court's processes? And if lawyers undertake obligations that may give rise to conflicting duties there is no reason proffered for concluding that present rules regulating lawyers' duties to the court and to clients are insufficient to meet the difficulties that are suggested might arise.*

The *Fostif* decision is a robust endorsement of a "strong form" of third party litigation funding by a superior common law court. English courts are yet to go as far as the High Court, particularly concerning the degree of control the funder may have over the proceedings, but there are unmistakable signs that they are moving towards accepting a wider role for funders[22]. Litigation funding agreements have been upheld in South Africa and Canada[23]. However, even in Australia, commentators worry that post-*Fostif* "lingering uncertainties and controversies" remain about litigation funding[24]. I now consider these in turn.

5 Policy issues raised by litigation funding

The policy issues raised by third party funding, many of which were examined in the *Fostif* decision, can be broadly grouped into three areas:

- consumer protection;
- court protection; and
- lawyer's duties.

The articulation of each issue, how each issue is currently being addressed and a reflection upon what regulatory and Court rule changes are necessary, forms the balance of this presentation.

21 Fostif at [93] per Gummow, Hayne, Crennan JJ.

22 Arkin v Bouchard Lines Limited (No 2) [2005] EWCA Civ 655, [2005] 1 WLR 3055; R Mulheron and P Cashman, Third-Party Funding of Litigation: A Changing Landscape, (2008) 27 Civil Justice Quarterly 312-341 at 313.

23 See P Cashman, Class Action Law and Practice (Federation Press, 2007), 179-181. In relation to Canada, see P Puri, Financing of Litigation by Third-Party Investors: A Share of Justice? (1998) 36 Osgoode Hall L J 515-566.

24 See the articles by Peta Spender, a Professor of law at the Australian National University in P Spender, After Fostif: Lingering uncertainties and controversies about litigation funding, (2008) 18 JJA 101 and by Associate Professor Vicki Waye of the University of Adelaide in V Waye, Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs, (2008) 19(1) Bond L Rev 225.

5.1 Consumer Protection

Unscrupulous funders may take advantage of vulnerable litigants by imposing unfair or extortionate terms on them in funding agreements, misleading them about the risks or the disadvantages of the litigation or failing to fully disclose to them all relevant aspects of the funding agreements.

It is in order to address these consumer protection issues that IMF sought and obtained an Australian Financial Services Licence pursuant to Chapter 7 of the Corporations Act. At the time IMF offers to fund legal proceedings, prospective clients are provided with a Financial Services Guide and Product Disclosure Statement which sets out how IMF is paid for its services and how consumers who are dissatisfied with IMF's service can pursue a complaint.

All prospective clients of IMF are referred to Chapter 5 of IMF's Corporate Governance Manual which outlines IMF's dispute resolution process. This process provides for internal review of any complaint, at no charge to the complainant, and, if necessary, referral to an external body, the Financial Ombudsman.[25]

Obligations are imposed on IMF by virtue of the conditions which attach to IMF's Financial Services Licence and by virtue of the provisions of the *Corporations Act*. These obligations ultimately offer protection to parties seeking and obtaining funding from IMF. The conditions attaching to IMF's licence are largely financially related and include prudential requirements. The obligations imposed by the *Corporations Act*[26] are broader and encompass matters including an obligation to:

(a) do all things necessary to ensure that the financial services are provided efficiently, honestly and fairly;
(b) have in place adequate arrangements for the management of conflicts of interest;
(c) have available adequate resources to provide the financial services; and
(d) have adequate risk management systems.

Other provisions in the *Corporations Act* provide protection to consumers dealing with litigation funders in that they:

25 IMF has served over 20,000 clients and has received only one compliant, which was dealt with by the Ombudsman in IMF's favour.
26 A list of regulatory obligations imposed on IMF is at Attachment 5.

(a) provide for a cooling off period;

(b) provide that the licensee must not (in relation to the provision of a financial service) engage in unconscionable conduct;

(c) prohibit hawking of financial products; and

(d) prohibit false or misleading statements, misleading or deceptive conduct and dishonest conduct.

ASIC has a supervisory role in relation to the conduct of IMF's business pursuant to IMF's licence, with powers which include the power to suspend or cancel IMF's licence and to make a banning order prohibiting IMF from providing a financial service, permanently or for a specified period.

Funding a piece of litigation in the expectation of earning a return from it is an expensive, risky and protracted undertaking. Typically the litigation will take years to resolve. The funder has outlaid very substantial sums in legal costs and disbursements during that time and has likely incurred a significant exposure to adverse costs. It is imperative, from the funder's point of view, that the litigation funding agreement is not liable to be set aside on any ground, including maintenance and champerty, misrepresentation, misleading and deceptive conduct, unconscionability, oppression or any other basis which the funder can reasonably avoid.

If the agreement was to be struck down, particularly after the proceedings have been brought to a successful conclusion, then the funder will have wasted a very considerable investment and will have forgone any hope of earning a return on that investment. It behoves funders to act with scrupulous professionalism towards the litigants they fund and to enter into funding agreements which are likely to be seen as fair and reasonable having regard to all the circumstances of the funding and the risks attendant in the litigation.

5.2 Conflicts of Interest

Conflicts of interest may arise between the funder and the funded litigant which may lead to the litigant's legitimate interests being subordinated to those of the funder or being ignored altogether (for example the funder forces an early and cheap settlement on the litigant in order to improve the funder's cash flow or the litigant refuses to accept a reasonable settlement offer when the funder believes it would be prudent to do so).

I address this issue later by a comparison to conflicts between insurers and insureds and how the common law has addressed the issue of conflict in that context. The following clauses from IMF's funding agreement for multi-party actions go further than any policy of insurance in respect of this issue:

Clauses Dealing with Control and Conflict

(a) IMF will give day to day instructions; however the Claimant may override the instructions given by IMF by itself giving instructions to the lawyers.

(b) Except in relation to settlement, which is dealt with below, if the lawyers notify IMF and the Claimant that the lawyers believe they may be in a position of conflict with respect to any obligations they owe to IMF and those they owe to the Claimant, the Claimant and IMF agree that, in order to resolve that conflict, the lawyers may:

(i) seek instructions from the Claimant, which instructions will override those that may be given by IMF;

(ii) give advice to the Claimant and take instructions from the Claimant, even though such advice and instructions may be contrary to IMF's interest; and

(iii) refrain from giving IMF advice and from acting on IMF's instructions, where that advice or those instructions may be contrary to the Claimant's instructions.

Clauses Dealing with Settlement

(c) If the Claimant:

(iv) wants to settle the Claims or the Proceedings for less than IMF considers appropriate; or

(v) does not want to settle the Claims or the Proceedings when IMF considers it appropriate for the Claimant to do so;

then IMF and the Claimant must seek to resolve their difference of opinion by referring the matter to counsel for advice on whether, in counsel's opinion, settlement of the Claims (and the terms of any such settlement) is reasonable in all of the circumstances.

(d) The opinion of counsel will be final and binding on both the Claimant and IMF. If counsel's opinion is that the settlement is reasonable then the Claimant agrees that the lawyers will be instructed to do what is necessary to settle the Claims and / or the Proceedings on the basis advised by counsel.

Clauses Dealing with Termination by IMF

(e) IMF is entitled, at its sole discretion, to terminate its obligations by giving 7 days' written notice.

(f) IMF remains liable, however, for all Project Costs (as defined) and any Adverse Cost Orders attributable to the period of IMF's funding.

5.3 Capital Adequacy

The funder's promise to meet all adverse cost orders which may be made in favour of the defendant may turn out to be illusory if the funder lacks adequate capital or insurance leaving the litigant, unexpectedly, with a very substantial liability to meet, or the hapless defendant with a significant loss.

If all litigation funders in Australia were licensed, without being granted exemptions by ASIC, their Financial Services Licences would subject them to prudential regulation and certification by audit opinion.

The risk can be further ameliorated by the Court making security for costs orders, if concerns exist about the funder's financial position.

I now turn to stated concerns for our Civil Justice System arising from litigation funding.

5.4 Trafficking in Litigation

Are funders merely stirring up disputes where none exist or encouraging people to have recourse to the Courts when, absent the funder's intervention, they would have been unlikely to sue?

A funder, acting rationally, will not fund proceedings which have poor prospects of success, given the likely loss of its investment and its exposure to uncapped adverse cost orders. As Justice Austin said: *"…there is the commercial reality that IMF would not, acting rationally, prosecute litigation at its expense unless there were a reasonable prospect of a verdict or settlement…"*[27]

There is also less risk in funded litigation that a successful defendant will not be paid its costs.

The minority in *Fostif* reasoned that funders nevertheless ferment disputes by encouraging people to litigate who would not otherwise have done so, either because they were unaware of their injury or right to sue or because they simply chose not to sue.

Three responses, with respect, come to mind:

27 ACN 076 673 857 Ltd [2002] NSWSC 578; (2000) 42 ACSR 296

First If our laws, particularly laws created by the legislature to protect markets, are to be enforced and victims compensated, then victims have to be informed of their rights and given an opportunity to band together to bring proceedings to recover their losses. Funders can play a crucial role in each aspect of this process.

Secondly It takes 2 to tango. People will not litigate if their valid claims are paid without dispute.

Thirdly Who (outside of a Court) is to say that any particular piece of otherwise perfectly valid litigation ought not to be brought?

As Professor Spender observes: "pinpointing the difference between optimal litigation for socially beneficial outcomes and suboptimal trafficking in litigation is difficult."[28] It is preferable to let the Court decide whether any piece of litigation is merited or not on a consideration of the facts of the individual case rather than to shut people with legitimate claims out of Court altogether simply because they were organised and supported by a funder.

5.5 Abuse of Process

Does the Court have sufficient power to control any abuses by funders who are neither parties to the litigation nor officers of the Court?

Litigation funders are usually not a party to the litigation they fund and they are not subject to the disciplinary powers of the Court as they are not officers of the Court. However, the majority in *Fostif* had no difficulty in concluding that the Courts have sufficient powers to control any abuse of process or tendency to corrupt justice that might arise from the involvement of a litigation funder in proceedings. The role played by the lawyer for the claimants is an important component of this check.

28 P Spender, After Fostif above n 24, 107. Recall also Kirby J's comments in relation to this issue in Fostif at [202].

The Western Australian Court of Appeal in *Clairs Keeley* stated that:[29]

> *"…in terms of risk of abuse, there may be no difference between a litigation funder with an eye to maximizing profits and an insurance company with an eye to minimizing losses. Indeed, it may be said that the litigation funder has a greater incentive to ensure that he conducts himself properly. Not only are the funder's activities likely to be the subject of the close scrutiny, but any transgression is likely to have a markedly deleterious effect on the funder's ability to conduct business in the future. By contrast, only a small portion of an insurer's business is likely to lead to litigation."*

The Victorian Law Reform Commission in 2008 in its Civil Justice Review Report 14 outlined the Commission's key recommendations (and I quote):

First: an **overriding provision** to the effect that relevant legislation and procedural rules ought to be enacted to facilitate the just, efficient, timely and cost effective resolution of the real issues in dispute;

Second: new provisions should be enacted to **prescribe standards of conduct** in civil proceedings, to **facilitate cooperation** between the participants in a civil proceeding, **candour** and **early disclosure** of relevant information and early resolution of the dispute, **together with sanctions** and penalties for non-compliance with these overriding obligations; and

Finally: the **overriding obligations should be owed by the parties**, **lawyers and their legal practices** and "**any person providing any financial or other assistance to any party to a civil proceeding, including an insurer or a provider of funding or financial support**, insofar as such person **exercises any direct or indirect control or influence over the conduct of any party in a civil proceeding**".

This later recommendation reflects the fact that litigation funders, including insurers, have a greater capacity than most to systematically assist or retard the Court in achieving its overriding purpose.

29 Clairs Keeley (A Firm) v Treacy (No 1) (2003) 28 WAR 139 at [72].

5.6 Disclosure of Funders'/Insurers' Involvement.

Is the Court properly informed about the existence and terms of any funding and are defendants aware that the proceedings against them are being funded?

The VLRC Report recommended:

(a) that the parties should be required to **disclose the identity of an insurer or litigation funder** that exercises control or influence over the conduct of the insured or funded party in the course of the proceeding; and

(b) the court should have discretion to order disclosure of a party's insurance policy or funding arrangement if it thinks such disclosure is appropriate.

In my view, **disclosure** by funders and insurers **ought to be routine** rather than discretionary. This would facilitate the collection and analysis of **data** concerning funders and insurer's claims' management involvement in our civil justice system. Given the utilisation by funders and insurers of our subsidised system, our legislatures and Courts should consider collecting relevant data to ensure the funder/insurer interface with our civil justice system is properly understood and appropriately regulated. This data could include:

First: the number, type and value of claims funded by each funder and the number, type and value of defended claims funded by each insurer;

Second: the cost of the litigation to the funders, insurers and the Courts;

Third: the levels at which the parties were prepared to settle the case relative to the initial claim values; and

Finally: the value of settlements or judgments and the time each proceeding took to resolve.

This data may provide some surprising statistics. For example, it is acknowledged by the insurance industry that about 75 cents in every dollar paid out by insurers on directors and officers policies goes in defending the claims, with only 25 cents going to the claimants. This type of statistical data was powerfully used in the recent tort reform debate and must be relevant in any litigation funding debate.

Making funders, including insurers, accountable for their involvement in the Court process in the same way as the parties themselves, seems an obvious means of better protecting and promoting

the interests of the Courts as well as the interests of the consumers of the Courts' services. Costs orders directly against unsuccessful funders and insurers would add to the accountability.[30]

5.7 The Lawyer's Fiduciary and Ethical Duties

Does the existence of litigation funding undermine performance of the lawyers' fiduciary and professional obligations owed to the funded litigant? Can the lawyer exercise sufficiently independent judgment to freely advise the funded litigant, including in cases where the funder's interest may be harmed?

The tripartite relationship between funder, client and lawyer has the potential to create numerous conflicts. This may be of particular significance in multi-party proceedings, where the claimants could be more vulnerable to both the funder taking control of the proceedings and to lawyers who fail to sufficiently protect and promote the claimants' interests above their own.[31]

This includes the lawyer giving advice on the benefits and risks of the funding proposal – which might be seen to be an ethically perilous undertaking if the lawyer is financially dependant on the funder for the litigation to proceed.[32] Further, not only does the lawyer face potential conflicts between the funder's and the clients' interests, there is also a potential conflict between duties owed to *different* clients if the lawyer is retained by the funder and not directly by the litigants.[33]

Subject to certain caveats noted below, the involvement of lawyers in the funder-funded party relationship solves more problems than it creates. The interposition of lawyers into the funding equation is central to ensuring that the interests of the funded litigant are not subordinated to those of the funder and reduces considerably the risk that the funded proceedings may tend to corrupt the civil justice system.[34]

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30 In Arkin v Borchard Lines Ltd & Ors [2005] EWCA Civ 655 the Court of Appeal ordered the funder (as a non-party) to pay £1.3m as a contribution towards the costs of the successful defendants. The Court capped the funder's liability for adverse costs at the amount it had paid in the case for its client's own legal costs and disbursements. The Court observed at [42] that making funders liable for adverse costs means that: "Professional funders will also have to consider with even greater care whether the prospects of the litigation are sufficiently good to justify the support that they are asked to give. This also will be in the public interest."

31 V Waye, Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs, above n 24, 226,270.

32 Ibid 267.

33 Ibid 234-5. Note Waye's comments in relation to potential conflicts for the lawyer in respect of duties to different clients – she analyses this issue on the basis that the funder is a client of the lawyer. A conflict can also arise between duties to different clients who are both (or all) claimants. For example, a conflict arises for the lawyer where one claimant is part of a "test case" and wants to settle before issues of liability are determined for the benefit of the remaining claimants.

34 Lawyers, as officers of the court, are subject to the full disciplinary power of the court over any misconduct by them in the course of the proceedings. Lawyers provide safeguards for the system of justice outside of the courtroom as well. For example, the lawyers may be required to positively certify to the court, before filing any initiating process or defence, that the lawyers consider "there are reasonable grounds for believing on the basis of provable facts and a reasonably arguable view of the law that the claim or defence (as appropriate) has reasonable prospects of success": Legal Profession Act 2004 (NSW), s 347.

It is in the interests of the funder that experienced and competent legal advisers act in the proceedings – the funder will have little chance of earning a return if corrupt or incompetent advisers are retained. The funder can also be expected to improve the efficiency and cost effectiveness of the lawyers through the funder's imposition of budgets on the lawyers and general experience in managing litigation[35] and lawyers can foster the development of the funding industry and its competitiveness by advising their clients of the options available for funding litigation.[36]

As has been argued above, many conflicts of interest which are thought to be inherent in funded proceedings can be avoided or resolved by ensuring that the lawyers' fiduciary and professional duties to the litigants are given precedence over any duties or contractual obligations the lawyer may owe to the funder.[37] A properly drafted funding agreement will do just that.

This is so whether the funder or the funded litigant retains the lawyer. If the funder retains the lawyer, the funder generally seeks to control the proceedings (i.e. instruct the lawyers) – at least in jurisdictions where this is permitted, as in Australia. Provided the lawyers can still effectively discharge their duties to the funded litigants, the proceedings need not raise abuse of process or ethical concerns.

The insurance analogy comes to mind where solicitors represent both insurer and insured as principal, even though conflicts of interest may arise.[38] In case of a conflict of interest, the law prescribes the duties of the various parties including the solicitors involved.[39]

> Generally, the law assumes that a lawyer-client relationship exists between the solicitor appointed by the insurer and the insured, but not necessarily to the exclusion of a similar relationship with the insurer. Both the insurers and the solicitors they appoint owe a duty to

35 In QPSX Limited v Ericsson Australia Pty Ltd FCA 933 French J as he then was said at paragraph 54: "There is no doubt that the cost of litigation…can be very high. Even when conducted as efficiently as it can be with the aid of skilled advisers and technical experts, it is time consuming and expensive. The development of arrangements under which the cost risk of complex commercial litigation can be spread is at least arguably an economic benefit if it supports the enforcement of legitimate claims. Where such arrangements involve the creation of budgets by funders knowledgeable in the costs of litigation it may inject a welcome element of commercial objectivity into the way in which such budgets are framed and the efficiency with which the litigation is conducted."

36 The Solicitors' Code of Conduct (2007), Rule 2.03(d) requires solicitors in England and Wales to "discuss with the client how the client will pay [for the legal services to be provided], in particular . . . whether the client's own costs are covered by insurance or may be paid by someone else such as an employer or trade union."

37 P Spender, After Fostif above n 24, 114; V Waye, Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs, above n 24, 235. See also Law Council of Australia, Standing Committee of Attorneys-General, Litigation Funding (14 September 2006), [92]: "The Law Council submits that explicit measures to ensure independence of lawyers from LFCs are unnecessary."

38 See generally Mercantile Mutual Insurance (NSW Workers Compensation) Ltd v Murray [2004] NSWCA 151, 13 ANZ Ins Cas 61-612, Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd [2005] NSWCA 83 at [82]

39 See generally C Leigh-Jones, MacGillivray On Insurance Law, 10th Ed, (2005) at para 28-35.

> the insured to conduct the proceedings with due regard to the latter's interests, and an action in damages will lie for breach of that duty . . .[40]

Additionally, insurers have the right to decide upon the proper tactics to pursue in the conduct of the litigation, provided that they do so in what they *bona fide* consider to be in the interests of themselves and the insured.[41] When the insurer takes over the conduct of the insured's defence, each party comes under an obligation, as a matter of contractual implication, to act in good faith with due regard to the interests of the other.[42]

The common law rules that have been formulated to deal with insurance contracts are readily adaptable to the regulation of litigation funders presently under consideration. Indeed, the New South Wales Court of Appeal said: *'The insurance context provides a useful example of how the law copes adequately with a situation where control over litigation is given to a person who is not a party to the litigation itself."*[43]

Indeed, there seems no reason in principle or policy for a funder's involvement in litigation to be treated differently to insurers. At the extreme, if regulators and courts are discriminatory, there will be a tendency to worsen the inequality of arms between claimants and insurers presently so clearly in existence.

Disclosure of the terms of the funding agreement to the Court (as has been suggested above) also allows the judiciary to monitor any oppressive terms and guard against any improper incursion on the lawyer-client relationship by the funder.[44] In relation to the fear that the lawyers will compromise their professional duties to the litigants in return for the hope, or even the promise, of further work from the funder, it is submitted that very few competent law firms would be willing to risk damage to, or even the destruction of, their professional reputation and business which would flow from a finding that the firm had engaged in professional misconduct or an abuse of process.

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40 Project 28 Pty Ltd (Formerly Narui Gold Coast Pty Ltd) v Barr [2005] NSWCA 240 at [70]. The Court further noted at [83], as a factor against the argument that the litigation should be stayed because the funder had absolute control over it, that the funder had nominated "a reputable firm of solicitors to act in the name of the [funded litigant] and the solicitors, in turn, have retained counsel of eminence. There is no foundation for suggesting that the solicitors and counsel would allow the case to be conducted otherwise than with entire propriety." See also Fostif [2005] NSWCA 83 at [87] and Groom v Crocker [1939] 1KB 194 at 202-203.

41 Groom v Crocker [1939] 1 KB 194 at 203

42 K/S Merc-Scandia XXXXII v Lloyd's Underwriters [2001] 2 Lloyd's Rep 563 at 572-574.

43 Project 28 Pty Ltd (Formerly Narui Gold Coast Pty Ltd) v Barr [2005] NSWCA 240 at [70]

44 P Spender, After Fostif above n 22, 114. V, Waye Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs, above n 24, 270-1.

If the funder has the power to instruct the lawyers and chose to order them to take steps in breach of court orders or procedural requirements, the funder would be exposed to a contempt of court finding.[45]

It follows from the preceding discussion that the important role lawyers play in funded litigation may be compromised if any of the following are missing (these are the "caveats" referred to earlier):

(i) as noted, the lawyers' professional and fiduciary duties towards the funded litigants must not be overridden or compromised in any way by the terms of the funding agreement;

(ii) the lawyers must be competent, have relevant experience in the litigation being undertaken, be alive to the risk of conflicts arising and be able to give proper and objective advice to the litigants irrespective of the funder's views including, if necessary, advising the litigants of the desirability for them to take independent advice;[46]

(iii) there must be full and accurate disclosure to all funded litigants of the terms of the lawyers' retainer and of any other financial arrangements between the lawyers and the funder or any other party;

(iv) the lawyers must keep the funded litigants adequately informed of all significant developments in the litigation and must inform any litigant of any matter which might adversely affect that litigant's interests; and

(v) the litigants themselves must retain the right to instruct the lawyers directly in relation to their own claims in the event the lawyers' instructions come from the funder or, in a group proceeding, a committee or other representative.

45 Project 28, above n 40 [94]

46 Clairs Keeley (A Firm) v Treacy & Ors (No 2) [2004] WASCA 277 at [75]: "The Court can be more confident that its processes will not be abused by a litigation funder if the solicitor acting for the funded party is independent of the funder, is alive to the possibility of abuse or conflict and is fully aware of his [sic] fiduciary duties to his client."

A competent funder will ensure that each of these factors is provided for in the constitution and conduct of the funded proceedings.

6 Conclusion

Litigation funding has been subjected to intense judicial and regulatory scrutiny over the past 10 years or so since it emerged as an important option for claimants seeking to finance their litigation. It is gradually gaining acceptance by the courts, the legal profession, policymakers and the public around the world[47]. The legal principles under which it operates are becoming clearer.

This paper suggests that, viewed objectively, litigation funding is a positive development for the civil justice systems in which it operates. It unarguably enhances access to justice; not for all perhaps but certainly for many with genuine claims who are currently excluded from the system. And it improves the effective enforcement of the law, especially in competition and securities areas.[48]

There is always the risk, as exists in any industry, of rogue and unprincipled players seeking to exploit unwary litigants or undermine court process for commercial gain. But having regard to the safeguards which currently exist and the proposals for appropriate regulation in certain key areas in the future (including capital adequacy of funders and mandatory disclosure of their terms of trade), litigation funding poses little risk to the integrity of the justice system and the interests of consumers. The policymakers are right to encourage its continued development.

47 This acceptance is not, however, universal. Refer to Hall & Ors v Poolman & Ors [2007] NSWSC 1330 at paragraphs 370 to 397.

48 This is materially assisted by the presence of a workable class action procedure: M J Legg, The Transformation of a Share Price Fall into Litigation – Shareholder Class Actions in Australia, paper presented at the Corporate Law Teachers Association Conference, 3-5 February 2008, Sydney, Australia.