
Regulation of third party litigation funding in Australia

Position Paper

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Executive Summary

The Law Council of Australia's Board Executive resolved on 18 June 2010 that the Law Council would develop a Position Paper on litigation funding and class actions. The purpose of the paper was to set out areas in which regulation may be required for consumer protection, to minimise conflicts of interest and put an end to expensive satellite litigation over the propriety of litigation funding agreements.

The following have been identified as matters which regulation of guidance by ASIC would be supported by the Law Council:

1. clarification of restrictions on litigation funders performing legal work;
2. guidance as to the appropriate level of control by funders over the class action proceedings;
3. improved transparency in pricing practices under litigation funding agreements;
4. improvement of disclosure requirements in relation to some or all terms of the funding agreements to the Court, clients and defendants/respondents;
5. prudential regulation of litigation funders;
6. regulation of offshore litigation funders;
7. requiring that settlement of a funded matter be approved by the Court;
8. limitation of the role of litigation funders in settlement discussions, including prohibition on the funder dealing directly with the opposing party(s) and imposing a fiduciary obligation on the funder; and
9. specification of mandatory terms for litigation funding agreements, including cooling-off periods and provision of independent (secondary) legal advice for class members.

The Law Council considers other matters, including advertising and regulation of the conduct of legal practitioners, are most appropriately dealt with under existing and proposed national legal profession regulatory frameworks.

Background

1. This paper has been prepared by the Law Council of Australia (**Law Council**) Litigation Funding Working Group. The paper considers the need for improved regulation of litigation funding both in the context of third-party-funded representative proceedings, or class actions, and third-party-funded claims in the insolvency area and other single plaintiff actions.
2. The litigation funding industry has since 1995 enjoyed a statutory exception to the earlier common law prohibition against maintenance and champerty, in order to assisted company administrators and liquidators to pursue debts on behalf of creditors of a company. The industry subsequently expanded in Australia to fund class actions and large single plaintiff actions as successive superior court judgments overturned common law principles against 'maintenance' and 'champerty', imported from the British common law. In 2006, the High Court of Australia confirmed the legitimacy of third parties funding litigation, or agreeing to indemnify litigants for costs, in exchange for a percentage of any recovery.¹
3. Litigation funding usually involves the funder paying the cost of the litigation while indemnifying the litigant against the risk of paying the costs incurred by the respondent if the case fails. In the instance that the case is successful, the funder is reimbursed for the costs of the litigation and also receives a contractually agreed percentage of the any court awarded lump sum or settlement, which is typically between 25 and 40 percent.²
4. It is argued that litigation funding promotes access to justice, spreads the risk of complex litigation and improves the efficiency of litigation by introducing commercial considerations that will aim to reduce costs.³
5. The Law Council has previously made submissions to the Standing Committee of Attorneys General, noting the following:
 - (a) litigation funding companies (**LFCs**) have an important role to play in both insolvency and non-insolvency litigation as a means of creating an option for parties that would otherwise be prohibited from pursuing a legitimate claim, due to the cost of litigation;
 - (b) the price of litigation funding, similar to insurance products, will generally correspond with the risk involved in providing those services and should not be controlled by regulation, other than to foster healthy competition among litigation funders;
 - (c) arguments in favour of permitting LFCs to fund non-insolvency litigation greatly outweigh any arguments against, provided relatively simple criteria are met and courts accept a supervisory role;
 - (d) access to justice is the primary public policy consideration that should drive and inform any discussion about litigation funding or any proposed regulation;

¹ *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386; 229 ALR 58; [2006] HCA 41; *Mobil Oil Australia Pty Ltd v Trendlen Pty Ltd* [2006] HCA 42.

² Standing Committee of Attorneys-General, *Litigation Funding in Australia*, May 2006, pp 4 and 7.

³ *Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd* (2005) 63 NSWLR 203; 218 ALR 166; [2005] NSWCA 83, at [100]; *QPSX Ltd v Ericsson Australia Pty Ltd (No 3)* (2005) 219 ALR 1; 66 IPR 277; [2005] FCA 933, at [54].

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- (e) a 'one size fits all' approach is ill-adapted to the complexities of large-scale commercial litigation, which at present comprises the vast majority of non-insolvency litigation funded by LFCs in Australia.
 6. The Law Council has stated in the past that litigation funding is a fledgling industry in Australia, which must be allowed to develop and expand in the interests of access to justice. Over-regulation of litigation funding will stifle the industry's growth and inhibit the development of competitive forces required to lower the cost of these services.

Development of Australian class action law

7. Representative or group proceedings, which are commonly referred to as class actions, were permitted in the Federal Court following passage of the *Federal Court of Australia Amendment Act 1991*, which introduced Part IVA into the *Federal Court of Australia Act 1976* (Cth) allowing representative proceedings. In part, a mechanism for representative proceedings was intended to increase the level of product liability litigation in Australia.⁴
8. It is noted that litigation funding has influenced the direction and nature of class action litigation in Australia. Class actions generally cannot be maintained without a source of funding, given individual litigants will not bear the risk and expense of litigation in pursuit of a damages award for a relatively small individual loss. However, litigation funders will generally only bear the risk and expense if the settlement or compensation amount is readily quantifiable and the risks are not substantial relative to the expected reward.
9. Accordingly, third party funded class actions have more recently been in the area of commercial litigation arising out of product liability cases, allegedly illegal cartel behaviour, securities, alleged negligent conduct by company Boards and alleged overcharging for products, goods and services.
10. Class actions are now a more common occurrence in the Australian legal environment, although the number of actions remain quite low with there being only 12 funded class actions in the Federal Court as at 30 June 2009.⁵ However, litigation funding remains very much a 'work in progress'⁶, with many concerned that an appropriate regulatory framework should exist to protect consumers and put an end to costly satellite litigation over the propriety of litigation funding agreements.

Common law prohibition against maintenance and champerty

11. Legal principles most commonly applied to the issue of whether litigation may be financed by unrelated third parties were common law principles of maintenance and champerty.
12. Maintenance refers to the promotion or support of legal proceedings by a stranger who has no direct concern in them. Maintenance generally refers to the provision of financial assistance by a third party to support litigation. Champerty consists of unlawfully maintaining a suit in consideration of a bargain to receive, by way of

⁴ Senator the Hon Michael Tate, *Keynote address: Speech delivered at the AIC Product Liability Conference*, 11 November 1991.

⁵ See Prof. V. Morubito, *An Impirical Study of Australia's Class Action Regimes*, 2nd Report, September 2010, Monash University.

⁶ Stuart Clark and Christina Harris, 'Class actions in Australia: (Still) a work in progress', (2008) 31 *Australian Bar Review* 63.

reward, part of anything that may be gained as a result of the proceedings, or some other profit.⁷

13. Funding another person's litigation for profit ('champerty') was once a tort and a crime in all Australian jurisdictions. Courts only allowed litigation funding to occur pursuant to settled common law exceptions: if there was a bona fide community of interest between plaintiff and the funder, or if the plaintiff was impecunious and the funder was not acting with any collateral motive
14. The common law prohibition of litigation funding was justified on the grounds that it prevented abuses of court process (oppressive litigation, inflated damages, suppressed evidence, suborned witnesses) for personal gain. The concern was in part a doctrinal one, namely that the judicial system should not be the site of speculative business ventures. However it was also vexatious litigation which was sought to be prevented. In *Wild v Simpson* [1919] 2 KB 544 at 563, it was pointed out that the law was 'directed primarily, not at the client maintained, but at the other party to the litigation' – and that the other party to the litigation 'has the right to be free from litigation conducted by the assistance of persons working for their own interests'. The risk for parties to a litigation funding agreement was that the agreement might be voided by the Court.⁸
15. The common law offences and torts of maintenance and champerty were abolished in the United Kingdom in 1967.⁹ Gradually, the tort was abolished under the common law in most Australian jurisdictions, with the High Court finally putting an end to torts of maintenance and champerty in the remaining jurisdictions in 2006.¹⁰

Position at common law in Australia

16. In August 2006, the High Court of Australia handed down its decisions in the appeals against the ruling of the NSW Court of Appeal in *Fostif* and *Trendlen* cases.¹¹ *Fostif* and *Trendlen* involved substantially similar facts, effectively abolishing common law rules against champerty and maintenance.
17. In both cases, the High Court was asked to rule on whether the proceedings should be stayed for being contrary to public policy and an abuse of process. By a majority of 5:2, the High Court ruled that the proceedings were not an abuse of process or contrary to public policy, for the following reasons:
 - (a) there is no general rule against maintaining actions. Rules against maintenance and champerty had already been heavily qualified by the rules of insolvency and rules relating to subrogation applying to contracts of insurance;¹²
 - (b) a number of States (specifically NSW in this case) had passed laws abolishing the crimes and torts of maintenance and champerty, removing any foundation for concluding litigation funding agreements are generally contrary to public policy;¹³

⁷ Fleming, John, *The Law of Torts* (9th ed, 1998).

⁸ Stephen Davies, 'Maintenance, Champerty and Litigation Funding' (2001) 28 *Brief* 5.

⁹ Criminal Law Act 1967 (UK), ss 13, 14.

¹⁰ *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386; 229 ALR 58; [2006] HCA 41; *Mobil Oil Australia Pty Ltd v Trendlen Pty Ltd* [2006] HCA 42.

¹¹ *Ibid*

¹² *Ibid*, per Gummow Hayne and Crennan JJ at [89].

¹³ *Ibid*, paras [66]-[67].

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- (c) questions of illegality and public policy may still arise and there is no objective standard against which the fairness of the agreement may be measured. These are questions which must be answered according to the prevailing circumstances;¹⁴ and
- (d) existing substantive and procedural rules are sufficient to protect court processes.
18. Prior to the High Court's decision in *Fostif* and *Trendlen*, there appeared to be a presumption at common law that the existence of a litigation funding agreement gave rise to a claim of abuse of process. Following the decisions, it may be said that there is a presumption that funded proceedings are not an abuse of process unless public policy considerations are invoked which would bring the appropriateness of the arrangement into question.
19. Notwithstanding the decision in *Fostif* there have been some recent challenges by defendants in representative proceedings to the propriety of litigation funding arrangements, not the least of which brought on the recent reconsideration of whether litigation funding needed further regulation.¹⁵ The arguments raised in objection to litigation funding arrangements are technical but generally amount to the same public policy considerations which underpinned the torts of maintenance and champerty. For example, some argue that it is inappropriate for law practices to 'farm' mass litigation or for commercial parties to "trade in litigation".¹⁶ The suggestion is that because these actions commence in circumstances where there is no disincentive for class members (who bear little or no risk in joining the proceedings), the companies forced to defend against those actions are confronted with significant expenditure just to mount the defence. The commercial "trade" in litigation arguably subverts the primary function of the Court, which is to resolve legitimate disputes (noting that litigation funders often generate such disputes where they would not otherwise exist).
20. These are valid arguments, based on genuine concerns, which must be balanced against the principal benefits that arise from litigation funding and the extent to which the concerns can be addressed through regulation or judicial oversight. It is noted that while these concerns are valid the Law Council can find no example of a complaint by a class member about a third party litigation funder or the application of the funding.

Abuse of process

21. Much of the uncertainty surrounding the legal status of litigation funding agreements at common law was resolved by the High Court's decisions in *Fostif* and *Trendlen*.
22. The High Court agreed with the principal findings of Mason P in *Fostif*, that:

*"...the law now looks favourably on funding arrangements that offer access to justice so long as any tendency to abuse of process is controlled."*¹⁷

"The standard of proof for establishing an abuse of process and thereby obtaining the summary dismissal or permanent staying of proceedings is a high

¹⁴ Ibid, para 92.

¹⁵ *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* (2009) 256 ALR 427; *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2009] FCAFC 147 (20 October 2009)

¹⁶ E.g. *Fostif*, *ibid*, *Op Cit 10*, per Heydon and Callinan JJ at [266]

¹⁷ (2005) 63 NSWLR 203 at 227.

one (See *Williams v. Spautz* (1992) 174 CLR 509 at 518-520). Appropriately so, since questions of access to justice are involved.”

23. Prior to *Fostif* and *Trendlen*, where an LFC was found to have an excessive degree of control over a funded claim, the Court had ruled that the litigation constituted an abuse of process and stays were granted. For example, in *Clairs Keeley (a Firm) v Treacy & Ors* (2003) 28 WAR 139, the funding agreement between IMF Ltd and the plaintiffs assigned the plaintiffs’ cause of action to IMF Ltd, which was held to be, in effect, taking control of the litigation without reference to the plaintiff in any way. In *Marston v Statewide Independent Wholesalers Ltd* [2003] NSWSC 816 the funder had contractually constrained communication between the solicitors and the clients and this was held to be an abuse of process.
24. However, following *Fostif* and *Trendlen*, it is clear that the Court is now reluctant to find an abuse of process on the bases previously relied upon. For example, in *Jeffery and Katauskas Pty Ltd v Rickard Constructions Pty Ltd* (2009) 239 CLR 75, the High Court (by majority) rejected the appellant’s submission that the failure by the litigation funder to provide security for costs amounted to an abuse of process; while in *Deloitte Touche Tohmatsu v JP Morgan Portfolio Services Limited* (2007) 158 FCR 417, the Full Federal Court summarily rejected arguments by the appellant that there was an abuse of process, following the decision of the High Court in *Fostif* and *Trendlen*.
25. However, notwithstanding recent decisions of the High Court, there may be a need for guidance or regulation to ensure funding agreements are not able to impinge upon the solicitor-client relationship, or in any way constrain the capacity of a lawyer to act the best interests of their client.

What level of control is appropriate?

26. On the question of control, Mason P in *Fostif* stated that

*“[i]n any event, a measure of control is essential if the funder is to manage group litigation and also protect its own legitimate interests (Clairs Keeley (No.2) at [124]). The funder’s control in the present case is not excessive, especially since there is a solicitor on the record and since there are representative proceedings under judicial supervision. Firmstone has express written authority from each retailer to proceed as it is doing. One suspects that Firmstone is much better placed than individual retailers to make the forensic decisions necessary to deal with determined and well-informed opponents.”*¹⁸

27. The High Court further noted: “...that a person who hazards funds in litigation wishes to control the litigation is hardly surprising.”¹⁹
28. It is evident from the decision of the High Court in *Fostif* and other recent decisions that a significant element of control by the funder in proceedings will generally be tolerated, provided the funding agreement does not offend any rule of public policy. Indeed, the High Court noted the statements of Lord Mustill in *Giles v Thompson*,²⁰ that the rules against maintenance and champerty reflected “a principle of public policy designed to protect the purity of litigation and the interests of vulnerable litigants”. His Lordship referred to the fear that the presence of a funding agreement

¹⁸ Para [137].

¹⁹ *Fostif*, [2006], Ibid 8, per Gummow Hayne and Crennan JJ at para 89.

²⁰ [1994] 1 AC 142 at 164.

could have adverse effects on the processes of litigation and affect the “fairness” of the bargain struck between the funder and the intended litigant.

29. In response, the majority of the High Court stated 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”.²¹
30. In effect, the High Court has dismissed the notion that the existence of a funding agreement is sufficient to constitute an abuse of process – it will always be a question of degree. It is noted that this aspect of the decision has left room for extensive legal arguments regarding the appropriate extent of control by the funder.

Access to Justice

31. The Law Council considers that the justice system should be accessible to all, regardless of personal wealth. There is considerable public interest in encouraging and supporting mechanisms which improve access to justice.
32. In its 1995 report *Costs Shifting: Who pays for litigation?*, the Australian Law Reform Commission (ALRC) stated that “[c]ost is a critical element in access to justice. It is a fundamental barrier to those wishing to pursue litigation. For people caught up in the legal system it can become an intolerable burden.”²² The cost of litigation is clearly a prohibitive factor for many people seeking to right a civil wrong.
33. It is noted that most funded proceedings involve a commercial party, which requires security for the costs of pursuing creditors of an insolvent company. The majority of other cases involve a defendant which has wrongfully obtained a large aggregate benefit from a number of parties, who individually would have no viable prospects of recovery due to the overarching expense of legal action relative to the amount being recovered for each individual. There is clearly a public interest argument that such proceedings should be supported or maintained in order for the plaintiffs to receive any benefit at all.
34. The second reading speech accompanying *Federal Court of Australia Amendment Bill 1991*, which introduced Part IVA into the *Federal Court of Australia Act 1976* (Cth) allowing representative proceedings, stated:

“The Bill gives the Federal Court an efficient and effective procedure to deal with multiple claims. Such a procedure is needed for two purposes. The first is to provide a real remedy, where, although many people are affected and the total amount at issue is significant, each person’s loss is small and not economically viable to recover in individual actions. It will thus give access to the courts to those in the community who have been effectively denied justice because of the high cost of taking action.

“The second purpose of the bill is to deal efficiently with the situation where the damages sought by each claim are large enough to justify individual actions and a large number of persons wish to sue the respondent. The new procedure will mean that groups of persons, whether they be shareholders or investors, or

²¹ *Fostif* [2006], *ibid* at para 91.

²² *Cost Shifting: Who pays for litigation*, 1995, ALRC 75, page 17, available at <http://www.austlii.edu.au/au/other/alrc/publications/reports/75/ALRC75.html#ALRC75>

people pursuing consumer claims, will be able to obtain redress and to do so more cheaply and efficiently than will be the case with individual actions.”²³

35. In *Fostif*, the High Court recognised the importance of access to justice as a consideration which militates against a decision by the court to stop proceedings for an abuse of process in these circumstances:

“...it is important to recognise how exceptional it is for a court to bring otherwise lawful proceedings to a stop, as effectively the primary judge did in this case... The Court of Appeal recognised this consideration. Properly, it emphasised that it was for the appellants to establish that the respondent’s proceedings constituted an abuse of process

...

“The importance of access to justice, as a fundamental human right which ought to be readily available to all, is clearly a new consideration that stimulates fresh thinking about representative or ‘grouped’ proceedings.”²⁴

36. These statements demonstrate the value of representative proceedings to the civil justice system. However, as the following discussion indicates, the cost of these proceedings is often prohibitive without access to funding.

The role of solicitors

37. The Australian legal system is largely inaccessible to most people, except for the wealthy, those who qualify for legal aid (which is generally available only for criminal and family law disputes) or for plaintiffs in those states where private legal assistance schemes exist, such as South Australia and Western Australia (further discussion of these schemes is set out below). There is a ‘gap’ in the field of legal assistance for the majority, who are generally middle income earners with small to medium sized claims, as well as small to medium-sized businesses.
38. In the context of civil litigation, much of this ‘gap’ is met privately by solicitors offering services on a “no win no fee” basis, usually for an uplift fee to cover the solicitor’s risks of covering all expenses and costs of the proceedings²⁵ (subject to the point made in [39] below)
39. The ALRC considered these practices in a later report *“Managing Justice – A review of the federal civil justice system”²⁶*.

“Many of the parties involved in legal disputes are unable to pay the full costs of the legal advice and representation that they require. They frequently receive assistance from lawyers for less than the market cost of their services, for no cost (pro bono) or on a deferred or delayed charge basis. The lawyer and client may agree there is no charge if the case is unsuccessful or set a fee uplift (a set

²³ Second reading speech for the Bill for the *Federal Court of Australia Amendment Act 1991* (Cth), House of Representatives, Parliamentary Debates, Hansard, 14 November 1991 at 3174.

²⁴ *Fostif* [2006], *Ibid Op Cit 10*, per Kirby J at [143]-[145].

²⁵ Whilst conditional fee arrangements are generally permitted in most Australian jurisdictions, it must be noted that access to justice in NSW has been significantly curtailed by the *Legal Profession Amendment Act 2005* (NSW), which introduced a ban on uplift fees in damages claims. This has effectively removed the capacity of law firms to incorporate the risk of accepting cases on a ‘no win, no fee’ basis into their fee structure, making speculative damages claims virtually untenable in that jurisdiction, to the significant detriment of impecunious plaintiffs.

²⁶ *Managing Justice – A review of the federal civil justice system*, (January 2000), ALRC 89 – see Executive Summary, available at <http://www.austlii.edu.au/au/other/alrc/publications/reports/89/>.

percentage increase) which is generally drawn from the client's award if successful, or other contingency fee arrangement. There are some restrictions on contingency fee arrangements. The Commission found these arrangements, and significant pro bono work from the legal profession, were common practices in federal jurisdiction. In some case types, lawyers carry much of the financial risk and provide considerable low cost assistance in litigation. The Commission commends and supports such practices."

40. While conditional fee arrangements are generally permitted in most Australian jurisdictions, it must be noted that access to justice in NSW has been significantly curtailed by the *Legal Profession Amendment Act 2005* (NSW), which introduced a ban on uplift fees in damages claims. This has effectively removed the capacity of law firms to incorporate the risk of accepting cases on a 'no win, no fee' basis into their fee structure, making speculative damages claims virtually untenable in that jurisdiction, to the significant detriment of impecunious plaintiffs.
41. However, it is generally not viable for most law firms to fund representative proceedings on a conditional basis. Facilitated opt-out class actions were introduced to assist some to access justice but a number of firms that have tried to run class actions on a conditional fee basis have failed. The price of failure is too high for many to risk it again. Only major firms with significant capital reserves have the financial capacity to fund large-scale commercial litigation – and generally not more than one at a time, due to the high risk and cost involved. While law firms are able to facilitate access to justice for some, this work is but a fraction of the overall assistance required for plaintiffs in this area.
42. When a Part IVA class action proceeds on a conditional fee basis the lead applicant must bear all the risk, including the risk of an adverse costs order and the law firm must be willing to risk years and millions to take it through to conclusion. LFCs offer, in some circumstances, a way to take the meritorious claim forward.²⁷

The role of funders

43. The role of LFCs in the civil justice system has been endorsed in recent years as a means of ensuring justice is served in circumstances where the cost, relative to the amount being claimed, is too great to be borne by law firms or individual claimants.
44. LFCs generally fund less risky commercial proceedings, where the award is more easily quantifiable according to the financial loss of the claimants. Proceedings involving personal injury or recoveries that are assessed according to an "approximate" loss are generally considered too risky for funders that engage in proper due diligence, particularly when success is less certain.
45. Given the efficiency of dealing with multiple claims, noted in the comments of the High Court in *Fostif*, above, there is clearly a public interest in a robust litigation funding market where sufficient capital is available to underwrite the risks associated with large group claims. These benefits could extend, for example, to people injured in major industrial accidents, mass latent injury claims against corporations or other entities, where there is evidence of negligence or recklessness as to employee or community safety, claims for injuries resulting from environmental damage or defective products, etc.

²⁷ Although note the difficulty identified in paragraphs 40-48 below.

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46. Justice French of the Federal Court of Australia (as he then was) in a paper presented at the Second Anti Trust Spring Conference on 29 April 2006 discussed the efficiency of representative proceedings:

"It may be said that the evolution of arrangements under which the costs risk of complex commercial litigation can be spread is arguably an economic benefit if it supports the enforcement of legitimate claims. If such arrangements involve the creation of budgets by commercial funders which are knowledgeable in the costs of litigation it may inject an element of commercial objectivity into the way in which such budgets are framed and the efficiency with which the litigation is conducted. The formation of such a budget does not amount to the assumption by the funder of control of the conduct of the litigation. It is not for the court to judge such arrangements as contrary to the public interest unless it can be shown that a particular arrangement threatens to compromise the integrity of the court's processes in some way. See QPSX v. Ericsson (No. 3) (2000) 66 IPLR 277 at 289 – 90".

47. It should also be noted that the new s 37M of the *Federal Court of Australia Act* imposes upon all courts an "overriding purpose" to resolve the real issues before the court as quickly, inexpensively and efficiently as possible.²⁸

Private regulation of public laws

48. Class actions by consumers, shareholders or other groups with a common complaint perform a private regulatory function.
49. In essence, class actions are used to address market failure. Companies which overcharge for goods and services or negligently cause losses in share value, for example, may not suffer any consequences by way of government regulation or enforced restitution. However, class actions enable a group of claimants with a common interest to redress misconduct and recover their losses efficiently, thereby addressing the market failure.
50. The counter-argument is that third party litigation funders and the lawyers who work with them 'farm' for cases by identifying the causes of action and actively finding the clients to pursue a claim or claims. For example, following a sharp reduction in share price for a publicly listed company, a litigation funder or law practice may investigate to determine whether a failure or breach of duties by the company's board contributed to the losses and subsequently invite shareholders to opt-in to a claim against the company to recover compensation for the reduction in share price. This activity is criticised as performing the role of a regulator rather than that of a private solicitor acting on instructions.
51. It is argued that the primary function of the Court is subverted by these kinds of disputes, which exist only because unrelated parties are conducting a business of trafficking litigation. In *Fostif*, Callinan and Heydon JJ said:

"... 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

²⁸ Note also s 56 of the *Civil Procedure Act 2005 (NSW)* recent provisions in Victoria (Nick, check)

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."

52. The 'private regulation' argument survives this criticism, to a significant extent, because there is little other recourse for recovery of losses or ill-gotten gains in circumstances where the value of the loss for each person is too low to contemplate the expense and risk of litigation and there is no regulatory process to enforce recovery. Arguably, the Federal Government could require the Australian Securities and Investments Commission (ASIC) or the Australian Competition and Consumer Commission (ACCC) to investigate complaints and, where necessary, issue orders or prosecute the alleged misconduct. However, such an approach would be unlikely to result in restitution for those who have suffered losses.

Regulation of Litigation Funding

53. Presently in Australia, there is no formal regulatory framework applying to litigation funders. Litigation funding is controlled largely by supervision of the Court, the *Trade Practices Act 1974*, the *Federal Court of Australia Act 1976* and other State/Territory consumer protection legislation. At common law, there are no formal restrictions on litigation funding arrangements other than the Rules of the Court and the Court's consideration of whether the proceedings constitute an abuse of process (an avenue of objection which has been substantially narrowed by the High Court's ruling in *Fostif* and *Trendlen*).
54. Despite the High Court's ruling in *Fostif* and *Trendlen* cases,²⁹ there continues to be substantial satellite litigation in funded matters involving wasteful litigation over the legitimacy of the funding arrangements. Some have argued that the lack of a legislative framework for litigation funding at the federal or State/Territory level may propagate uncertainty, notwithstanding the High Court's approbation of litigation funding arrangements. Accordingly, there have been calls to establish a formal regulatory framework for litigation funders, both to protect consumers and to ensure the ongoing viability of third party litigation funding.

Multiplex decision

55. On 20 October 2009, the Full Court of the Federal Court (Court) found in the Multiplex decision³⁰ that Maurice Blackburn Pty Ltd and/or International Litigation

²⁹ *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386; 229 ALR 58; [2006] HCA 41; *Mobil Oil Australia Pty Ltd v Trendlen Pty Ltd* [2006] HCA 42.

³⁰ *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* (2009) 256 ALR 427; *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2009] FCAFC 147 (20 October 2009)

Funding Partners Inc were involved in the conduct of an unregistered managed investment scheme.³¹

56. As a result of the Court's finding, all litigation funding schemes involving more than 20 potential claimants had to be registered with the ASIC and satisfy the requirements of the *Corporations Act 2001* (Cth), including the appointment of a suitably qualified responsible entity, unless.
- (a) an exception applies under the Corporations Act, such as the "sophisticated investors" exemption under Chapter 6D; or
 - (b) an exemption is obtained from ASIC.

Federal Government's response to the Multiplex decision

57. In response to the Court's finding, the Commonwealth Treasury convened a round table discussion in Sydney on 10 March 2010 for selected stakeholders, in order to discuss the government's immediate response to the Multiplex decision.
58. On 4 May 2010, the then Minister for Superannuation, Financial Services and Corporate Law, the Hon Chris Bowen MP, announced that the Federal Government would overturn the Multiplex decision by implementing a regulatory carve-out for funded class actions.³² In doing so, the Minister cited the considerable benefits of litigation funding and class actions as an efficient access to justice mechanism and noted the lack of any significant contingent risks for consumers.
59. The Federal Government recognised that class actions are already subject to a regulatory regime consisting of Commonwealth and State legislation, court rules, and the legal profession rules protecting the interests of clients. Therefore, the government did not consider it necessary to impose further regulatory burdens for litigation funders.
60. The Minister also announced that the Federal Government is considering providing an exemption from the licensing and other requirements in Chapter 7 of the Corporations Act, subject to appropriate arrangements being put in place to manage conflicts of interest. ASIC may produce a regulatory guide about managing the conflicts of interest that may arise, following a public consultation process.
61. On 7 May 2010, ASIC released an Interim Class Order in relation to funded representative proceedings, which exempted funded proceedings from the definition of managed investment schemes in s 9 of the Corporations Act and the disclosure requirements which follow.³³ The Interim Class Order also exempted funders, lawyers and their representatives from the requirement to hold an Australian

³¹ The Multiplex MIS Full Court decision resulted from an appeal from a decision of the docket judge in the Multiplex case, Finkelstein J, who typified the application by Multiplex as an attempt to stop the class action in its tracks. He found that the litigation funding arrangements were not a managed investment scheme, and observed that: "[t]he essence of a managed investment scheme, stripped of all its technicalities, is a scheme in which people invest money (or money's worth) in a common venture with the expectation of profit that will result from the efforts of others. That is not what has happened here." (*Brookfield Multiplex Limited v International Litigation Funding Partners Pte Ltd* (No 3) [2009] FCA 450 (6 May 2009) at [37])

³² Minister for Superannuation, Financial Services and Corporate Law, the Hon Chris Bowen MP, *Government Acts to Ensure Access to Justice for Class Action Member* (4 May 2010), available at <http://mfsscl.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/039.htm&pageID=003&min=ceba&Year=&DocType=0>.

³³ Australian Securities and Investment Commission (ASIC), *ASIC Class Order [CO 10/333] – Funded representative proceedings and funded proof of debt arrangements*, available at [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/co10-333.pdf/\\$file/co10-333.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/co10-333.pdf/$file/co10-333.pdf).

Financial Service Licence (AFSL) or act as an authorised representative of a licensee to provide financial services associated with funded proceedings.

62. The relief means that current funded representative proceedings and proof of debt arrangements can progress and new funded representative proceedings and proof of debt arrangements can be commenced without needing to comply with specific requirements, including:
- (a) registering the scheme with ASIC;
 - (b) adopting a complying constitution and compliance plan for the scheme;
 - (c) appointing an AFS licensed public company as ‘responsible entity’;
 - (d) preparing a Product Disclosure Statement; and
 - (e) providing ongoing disclosure to members of the scheme.
63. In September 2010, ASIC issued a further Class Order, extending relief until 31 March 2011. In February 2011 ASIC issued another Class Order extending relief until 30 June 2011.
64. ASIC has advised that, once a regulatory reform is introduced, giving effect to the Minister’s announcement on 4 May 2010, ASIC will release draft ‘guidelines’ for consultation, which will address conflicts of interest between funders, class action lawyers and their clients. It is expected that the regulations will be released for comment by Treasury in May, and introduced in order to have effect by 1 July 2011.

The Chameleon Mining case

65. In *International Litigation Partners Pte Ltd v Chameleon Mining NL* [2011] NSWCA 50 the NSW Court of Appeal found that the litigation funder was required to hold a financial services licence as the funding agreement between Chameleon and the funder was a ‘financial product’. It was the Court’s view that the agreement involved ‘managed financial risk’ as per section 763A of the *Corporations Act 2001* (Cth).
66. Despite the decision of the NSW Court of Appeal there is unlikely to be any practical effect on litigation funders due to ASIC Class Order 10/333, which exempts litigation funders from holding a financial services licence.
67. However, the decision raises policy questions as to whether litigation funders should be excluded from the financial services regulation if they are providing financial services, even where risk to consumers may be remote.

Arguments against financial services regulation

68. The Law Council acknowledges the following arguments favouring limited regulation of litigation funding arrangements:
- (a) Group members in class actions are protected by the Court and by statute in the following ways:
 - (i) class actions are regulated under the class action provisions contained in Part IVA of the Federal Court of Australia Act and the equivalent State provisions;

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- (ii) section 33V of Part IVA of the Federal Court of Australia Act provides that court approval is required for a settlement or discontinuance. Any settlement must be fair, reasonable, adequate and in the interests of the group members, which includes fairness as between group members;
 - (iii) the Federal Court has a general supervisory power to make orders to ensure that “justice is done” in s 33ZF of Part IVA of the Federal Court of Australia Act;
 - (iv) class actions are conducted by solicitors whose conduct is regulated by the *Legal Profession Act* in each state and territory and by their duty as officers of the court conducting the litigation;
 - (v) the proceeds of a class action are received by a solicitor who has a statutory obligation to pay the monies into a regulated and audited trust account, which is also protected by a statutory compensation scheme.
- (b) Pro forma funding applications used by major litigation funders contain standard provisions, which mitigate the key risks that are commonly argued to arise for class members.
 - (c) It is difficult to assess what risks might arise for fidelity funds and professional indemnity insurance policies, however class members generally do not contribute any funds to meet costs.

Outstanding Issues

69. The Law Council is concerned that a number of policy issues relevant to funded class actions remain unresolved and must be given due consideration by both the government and the legal profession. These issues are summarised, as follows:.

Professional duties of lawyers

- (a) Whether there is a need for further regulation, by way of professional conduct rules or Legal Practice Acts, of the role of legal professionals in funded proceedings;
- (b) Whether legal professionals who conduct class actions can remain sufficiently independent from litigation funders to avoid any conflict of interest toward their clients;
- (c) Whether limits should be imposed on a funder’s control so that primacy is given to the lawyer’s obligation to the court;
- (d) The potential risk for legal professional fidelity funds or professional indemnity insurance schemes should a case emerge in which a large class of funded litigants takes action against the fidelity fund or law practice for negligence or some other impropriety;

Duties of and restrictions on litigation funders

- (e) The need for guidance over conflicts of interests for funders, including prohibition on acting for opposing/related parties in proceedings;
- (f) Whether funders ought to be regarded as owing fiduciary duties to funded litigants.
- (g) Whether additional regulation is required to minimise the consequences of a major collapse or malfeasance by a litigation funder, which might leave the defendant with no recourse to recover costs; and
- (h) Whether a prudential requirement should be put in place to ensure that the funder has the resources to pay any adverse costs order, and in the instance that such an order is made, whether legislative provisions should be put in place to compel the payment of an adverse costs order by the funder.

Law Council Position

- 70. The Law Council notes that there is room for ASIC issued guidelines or appropriate regulation of the activities of litigation funders. However, the Law Council does not support regulation of legal practitioners in respect of their engagement with litigation funders and clients supported by them outside the national legal profession regulatory framework. Accordingly, it will be necessary to consider the extent to which the guidelines are complementary to the regulation of the legal profession and do not encroach on the harmonised national legal profession regulatory framework.
- 71. The Law Council considers that the following matters could be addressed in the guidelines or through appropriate regulation of the litigation funding industry:

Restriction on legal work

Clarification of restrictions on litigation funders performing legal work

- 72. Just as there exist general prohibitions against legal practitioners dealing in financial products or charging “contingency fees” in litigation, litigation funders should be prevented from performing legal work on behalf of the lead applicant or class members in funded proceedings.

Control over proceedings

Guidance as to the appropriate level of control by funders over the class action proceedings
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- 73. Whilst acknowledging, as did the High Court in *Fostif*, that a person who hazards funds in litigation naturally wishes to control the litigation,³⁴ it is considered reasonable that a third party, whose only interest in the dispute is a financial stake in the outcome, should have some limits placed on their control over the proceedings. Solicitors, regardless of whether an uplift fee is involved, are required to act in the best interests of the client at all times and must generally seek instructions before making significant decisions with respect to their client’s claim.

³⁴ *Fostif*, [2006], Ibid 8, per Gummow Hayne and Crennan JJ at para 89.

Transparency

Improved transparency in pricing practices under litigation funding agreements

Improved disclosure requirements in relation to some or all terms of the funding agreements to potential litigants

Requirement that litigation funders disclose existence of funding agreement to the Court, as well as the identity of the funder

Requirement that lead applicant advise defendant if litigation funding agreement does not contain a costs indemnity clause

Requirement that the lead applicant provide a sealed copy of the litigation funding agreement to the Court

74. Just as insurers and financial institutions are generally required to fully disclose all costs associated with their policies, derivatives and products, it is reasonable to expect litigation funders to meet a certain standard of transparency, to ensure the client understands and agrees to the terms of the arrangement prior to entering into it.
75. Applicants should be required to advise the Court if they have entered into a litigation funding agreement or insurance arrangement, under which a third party will indemnify the applicant(s) in respect of any costs in the proceedings; and to advise the Court and the respondent of the litigation funder's identity.
76. It is also reasonable to expect that the lead applicant should advise the respondent in the proceedings if the litigation funder has not agreed to indemnify the class in respect of an adverse costs order made by the Court.
77. To ensure transparency, while protecting the applicants from disclosing the exact terms of the litigation funding agreement, the lead applicant should be required to provide a sealed copy of the litigation funding agreement to the Court, to enable appropriate supervision by the Court without disclosing the terms of private contractual agreements to other parties.

Prudential regulation

Prudential regulation of litigation funders

78. As litigation funders' pricing practices are generally a product of assessing risks associated with litigation, in a manner similar to general insurance products, there may be merit in considering whether oversight by the Australian Prudential Regulation Authority might be appropriate.

Offshore funders

Regulation of offshore litigation funders

79. Offshore litigation funders may present additional risks to those presented by litigation funders domiciled in Australia. Those risks are controlled, to a certain extent, by the ordinary practice of parties requesting security for costs. However, consideration should be given to any additional risks that might be posed by

offshore litigation funders and how those risks might be controlled (without creating a disincentive for foreign litigation funders to offer service in Australia).

Supervision

Requiring that settlement of a funded matter be approved by the Court

80. It is considered appropriate that the Court should have ultimate oversight of settlement agreements in funded matters. This will minimise the risk of an agreement being negotiated and executed without the informed consent of the parties and without independent legal advice being provided.

Limit on control over proceedings

Limitation of the role of litigation funders in settlement discussions, including prohibition on the funder dealing directly with the opposing party(s) and imposing a fiduciary obligation on the funder

81. Given the primary motivation of litigation funders is profit, there is little incentive to act in the best interests of clients, particularly in settlement negotiations. For this reason, funders should not represent the claim group during any discussions affecting the claim – this role should continue to be exclusively carried out by the legal representatives for the class and only after receiving appropriate instructions from the lead applicant.

Mandatory terms

Specification of mandatory terms for litigation funding agreements, including cooling-off periods and provision of independent (secondary) legal advice for class members

82. It may be possible to minimise many of the risks to clients on entering into a litigation funding agreement by mandating specification of certain terms, such as cooling off periods (which are commonplace under insurance contracts) and the provision of independent legal advice (to limit any perception of an improper relationship between the litigation funder and the legal advisers appointed to run the claim).

Advertising

Existing regulation of advertising by litigation funders (and new class action firms) is sufficient

83. Advertising by litigation funders is already sufficiently regulated under existing Federal and State/Territory consumer protection laws, including the *Competition and Consumer Act 2010* (Cth) and State and Territory fair trading laws.
84. Advertising by legal practitioners should be regulated under the national legal profession legislation. The Law Council does not support additional regulation of advertising by law practices outside legal profession regulation and existing consumer protection statutes.

Attachment A: Profile of the Law Council of Australia

The Law Council of Australia is the peak national representative body of the Australian legal profession. The Law Council was established in 1933. It is the federal organisation representing approximately 50,000 Australian lawyers, through their representative bar associations and law societies (the “constituent bodies” of the Law Council).

The constituent bodies of the Law Council are, in alphabetical order:

- Australian Capital Territory Bar Association
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society of the Australian Capital Territory
- Law Society of the Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar Association
- The Victorian Bar Inc
- Western Australian Bar Association
- LLFG Limited (a corporation with large law firm members)

The Law Council speaks for the Australian legal profession on the legal aspects of national and international issues, on federal law and on the operation of federal courts and tribunals. It works for the improvement of the law and of the administration of justice.

The Law Council is the most inclusive, on both geographical and professional bases, of all Australian legal professional organisations.