Litigation Funding: Access and Ethics

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The Hon Justice S C Derrington
President, Australian Law Reform Commission

I. CLASS ACTION PROCEEDINGS IN AUSTRALIA

In March 1992, Part IVA of the *Federal Court of Australia Act 1976* (Cth) (the FCA Act) introduced a federal class action regime within Australia. Subsequently, similar class action procedures have been introduced in Victoria,[1] New South Wales,[2] and Queensland.[3]

It was not expected that the new regime would have a significant financial impact nor was there expected to be a significant increase in the number of cases brought.[4]

As has been observed elsewhere,[5] the legislation did not have bipartisan support. There were four principal concerns about the regime: first, it was said to be an attack on the traditional method of exercising legal rights; secondly, there were fears it would foster a litigious culture in Australia; thirdly, it was thought it would change the nature of legal practice by the creation of an entrepreneurial class of lawyer promoting proceedings; fourthly, it was seen to be a misdirected overreaction to the problem of the cost of litigation. Former Attorney-General Senator Durack remarked,

> A number of people would even go so far as to say that [this Bill] is a monstrosity … It really is one of those rather loopy proposals that come up from time to time from commissions like the Law Reform Commission.[6]

These fears have, in large measure, not materialised. As was intended, the regime has enabled claims to be brought by people with small claims whose number may be such as to make the total amount at issue significant, and to deal efficiently with similar individual claims that are large enough to justify individual actions. To date, the cases that have been brought under the regime reflect a broad range of both commercial and non-commercial causes of action, including shareholder and investor claims, anti-cartel claims, mass tort claims, consumer claims for contravention of consumer protection law, environmental claims, trade union actions, claims under the *Migration Act 1958* (Cth),[7] and human rights claims. One of the more recent examples of the type of matter that, under the Part IVA regime, was expected to enhance access to justice is the formal apology and settlement award of $30 million to 447 residents of Palm Island in their action against the Queensland Government following riots in 2004.

Despite the concerns that the floodgates of litigation would open as a consequence of Part IVA, the number of class actions has grown steadily, but not exponentially since the introduction of the legislation. In the first 12 months of its operation, eight class actions were filed; seven were filed in the following 12 months; and a further 14 in the subsequent 12 months. Twenty-five class actions were filed in the Federal Court in 2016–2017.[8] This represents 0.53% of the total number of causes of

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1 Part 4A, *Supreme Court Act 1986* (Vic) (with effect from 1 January 2000).
2 Part 10, *Civil Procedure Act 2005* (NSW) (with effect from 4 March 2011).
3 Part 13A, Civil Proceedings Act 2011 (Qld) (with effect from 1 March 2017).
4 Ibid; Explanatory Memorandum, *Federal Court of Australia Amendment Bill 1991* (Cth) [5].
5 Chief Justice JLB Allsop, 'Class Actions' (Speech, Law Council of Australia, 13 October 206).
6 Commonwealth, *Parliamentary Debates*, Senate, 13 November 1991, 3019.
7 Amendments to the *Migration Act 1958* in 2001(s 486B(4)) prohibited the use of the Part IVA regime in any proceedings relating to visas, deportations or removals of non-citizens.
8 Vince Morabito, 'The First Twenty-Five Years of Class Actions in Australia: An Empirical Study of Australia's Class Action Regimes, Fifth Report' (July 2017) 24.

action filed in the Federal Court over the same period. To date, approximately 15.4 class actions have, on average, been filed annually in the Federal Court of Australia since the regime commenced in 1992.[9] There are currently 94 representative proceedings in the Court nationally.

If a criticism could be levelled at Part IVA regime, as it was introduced, it was that neither the Part IVA, nor any other relevant legislation, dealt with the issue of an appropriate costs regime—leaving unanswered the difficult question of how to relieve a principal applicant from the brunt of an adverse costs order should the proceeding fail. A recommendation to establish a public fund to protect principal applicants in the face of such an eventuality[10] was not adopted by the government of the day. In the ALRC's current Inquiry, no one argued that such a recommendation should be re-enlivened.

Inevitably, innovation deals with gaps in the law and, as the class action regime has matured, commercial third-party litigation funding has become a particular feature of the Australian class action landscape. Litigation funding has largely filled the lacuna created by the absence of a satisfactory mechanism to protect principal applicants from adverse costs orders. At its simplest, such funding involves a third-party (a litigation funder) with no direct interest in the proceeding agreeing to fund litigation in return for a share of any amount recovered if the case is successful.

The decision of the High Court of Australia in *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (*Fostif*) in 2006 confirmed the legitimacy of third-party litigation funding arrangements in Australia.[11]

Since *Fostif*, the number of domestic and international funders operating in the Australian market has grown steadily with approximately 25 funders active in the Australian market. In the period from September 2013–September 2016, approximately 49% of all class actions filed in the Federal Court were funded by third-party litigation funders.[12] From 2013 to 2018, the percentage of funded class actions proceedings grew to 63.9%, with funded class action proceedings filed in the final year of that period constituting 77.7% of all filed class actions.[13]

The conditions in Australia that are said to have allowed litigation funding to flourish include: the opt-out model; the very high costs involved in conducting large-scale class actions; the cost shifting rule; the lack of a public fund or other mechanism to finance class actions,[14] and the prohibition on lawyers charging contingency fees.[15]

II. OVERVIEW OF THE LITIGATION FUNDING MARKET

As already observed, third-party litigation funding refers to an arrangement whereby a third party, who has no other connection to the litigation, finances some or all of a party's legal costs (which can include solicitors' fees, counsels' fees and other disbursement) in return for a share of any proceeds of the litigation. Calculation of the funder's share of the proceeds is typically based on a percentage of the sum recovered or a multiple of the funding provided.

This relatively straightforward form of litigation funding is, however, no longer the only funding model being used in the litigation funding market. A much wider range of funding models has emerged, and they continue to evolve. Portfolio funding or law firm financing is being promoted as an alternative to case-by-case funding. Broadly, there are two types of arrangements: the first involves finance

[9] Vince Morabito, 'Empirical Perspectives on 25 Years of Class Actions' in Damian Grave and Helen Mould (eds), *25 Years of Class Actions in Australia* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2017) [4.2]. In the state courts, the average number of class action filings, since the introduction of a class action regime in Victoria, Part 4A *Supreme Court Act 1986* (followed by NSW in 2011, Part 10 *Civil Procedure Act 2005* and Queensland in 2017, Part 13A *Civil Proceeding Act 2011*) is 6; Ibid.

[10] Australian Law Reform Commission, 'Grouped Proceedings in the Federal Court, Report 46' (December 1988) rec 3.09..

[11] *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (*Fostif*) (2006) 229 CLR 386, [65]–[95] (Gummow, Hayne and Crennan JJ).

[12] Morabito, above n 7, [4.3.2].

[13] Vince Morabito, Private correspondence (13 March 2018).

[14] Khouri, Attrill and Bowman, above n 11, [11.6].

[15] Jason Betts, David Taylor and Christine Tran, 'Litigation Funding for Class Actions' in Damian Grave and Helen Mould (eds), *25 Years of Class Actions in Australia* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2017) [10.2.2].

structured around a law firm, or department within a law firm, where the claimants are various clients of the firm; and secondly, finance structured around a corporate claim holder or other entity which is likely to be involved in multiple disputes over a defined period of time.[16] Some types of financing are increasingly a form of private equity, where third-party funders take an equity position in the claimant entity and, as such, gain control over its investment (in the litigation) through traditional corporate governance.[17] Additionally, some funders now establish Special Purpose Vehicles (SPVs) to receive investment funds from a variety of sources including pension funds and educational trusts.

The litigation funding market in Australia has been growing and industry revenue is forecast to grow at an annualised 7.8% over the five years through to 2022-2023. Revenue for the 2017-18 financial year is predicted to be $105.4 m with profit of $44.8m.[18]

The lack of homogeneity in the funding market poses difficulties for a single regulatory response to third-party litigation funders operating within Australia.

III. THE HISTORICAL CONSTRAINTS ON THIRD-PARTY FUNDING

Historically, arrangements whereby an unconnected third-party funded litigation in return for a share of the proceeds were unenforceable as a result of rules against barratry, maintenance and champerty. The law of maintenance, and the subsets of champerty and barratry, has been traced back to the *Statute of Westminster the First* (3 Edw I c 25) of 1275. Maintenance was the unlawful 'intermeddling with litigation in which the intermeddler has no concern'.[19] Champerty was 'maintenance aggravated by an agreement to have a part of the thing in dispute'[20] and barratry, relevantly for present purposes, was perpetrated by someone who was 'a common mover or stirrer up or maintainer of suits' – a serial maintainer.[21]

By the nineteenth century, it was already clear that the foundations on which the prohibitions against maintenance and champerty were laid had been crumbling for some time. In 1843, Jeremy Bentham's letters were published, in one of which he expressed the view that restrictions against litigation funding were a 'barbarous precaution' borne out of a 'barbarous age'.[22] In that same year Lord Abinger CB described the law of maintenance as:

> Confined to cases where a man *improperly, and for the purpose of stirring up litigation and strife, encourages others either to bring actions*, or make defences *which they have no right to make* … [By contrast], if a man were to see a poor person in the street oppressed and abused, and without the means of obtaining redress, and furnished him with money or employed an attorney to obtain redress for his wrongs, it would require a very strong argument to convince me that that man could be said to be stirring up litigation and strife, and to be guilty of the crime of maintenance.[23]

The future significance of third-party litigation funding as a means of enhancing access to justice was beginning to emerge. By the late 18th century, the policy had become the desire to ensure that individuals did not stir up litigation at no risk to themselves.

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16 ICCA-Queen Mary Task Force, *Report on Third-Party Litigation Funding in International Arbitration*, April 2018, 38–39.
17 Ibid 35.
18 IBISWorld, *Litigation Funding in Australia*, Industry Report OD5446, February 2018.
19 *Neville v London Express Newspaper Ltd* [1919] AC 368, 382.
20 *Wild v Simpson* [1919] 2 KB 544, 562.
21 *The Case of Barretry* (1588) (30 Eliz) 8 Rep 36; 77 ER 5.
22 Jeremy Bentham, *The Works of Jeremy Bentham* (ed. Bowring) (William Tait, 1843) Vol 3, Part 1, *A Defence of Usury*, Letter XII, *Maintenance and Champerty*, 19.
23 *Findon v Parker* (1843) 11 M & W 675, 682-683; 152 ER 976, 979.

The development of the jurisprudence of England & Wales, Australia, and Canada has followed similar paths towards broad acceptance of the legitimacy of third-party litigation funding, although Australia has released the shackles rather more definitively than has occurred in the other two jurisdictions.

England & Wales

In England & Wales, the first decision in which the practice of third-party litigation funding was approved, albeit limited to the insolvency context, was *Seear v Lawson* in 1880.[24] By the mid-1950s, exceptions to the prohibitions on maintenance had developed through the courts,[25] in parallel with the state-funded exception created by the introduction of legal aid in 1949.[26]

It was not, however, until 1967 that the *Criminal Law Act* 1967 (UK) abolished criminal and tortious liability for maintenance and champerty. Nevertheless, s 14(2) preserved any rule of law as to the cases in which a contract is to be treated as contrary to public policy or otherwise illegal.

It is the position in England & Wales that litigation funding agreements will be upheld so long as they contain no additional features which could be characterised as tending to 'undermine the ends of justice'.[27] The current law was summarised by Coulson J in *London & Regional (St George's Court) Ltd v Ministry of Defence* in which Sir Peter said that, in considering whether an agreement is unlawful on grounds of maintenance or champerty, the question is whether the agreement has a tendency to corrupt public justice and that the rules against champerty, so far as they have survived, are primarily concerned with the protection of the integrity of the litigation process in this jurisdiction …'.[28]

Canada

In Canada, the prohibition against champerty has long been codified in the *Act Respecting Champerty* RSO (1897) (the *Champerty Act*).

The concept of champerty in Canadian law invokes similarly the concept of proper and improper motives underpinning litigation funding. The relevance of motive in an assessment of maintenance and champerty was reaffirmed in the 1993 decision of *Buday v Locator of Missing Heirs Inc*.[29]

Maintenance and champerty were removed from the *Criminal Code* in 1953. However, under the *Champerty Act*, champerty remained a tort in common law jurisdictions and has typically had the effect of acting as a shield against the enforcement of champertous agreements.

The Canadian courts have recently had occasion to consider the law regarding the approval of third-party funding agreements in the class action context in *Houle v St Jude Medical Inc.*[30] The court confirmed that 'deciding whether to approve a [third-party funding agreement] will depend upon the particular circumstances of each case';[31] and that the court must be satisfied of at least four criteria to approve a third-party funding agreement:[32]

(1) the agreement must be necessary in order to provide access to justice;

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24 (1880) 15 Ch D 426.

25 *Martell v Consent Iron Co Ltd* [1955] Ch 363, 399-400.

26 *Legal Aid and Legal Advice Act* 1949 (UK).

27 Damian Grave, Maura McIntosh and Gregg Rowan (eds), *Class Actions in England and Wales* (Sweet & Maxwell, 2018) [8-052].

28 [2008] EWHC 526 (TCC); (2008) 152 (14) SJLB 28 [103].

29 (1993) 16 OR (3d) 257, 268.

30 2017 ONSC 5129 (an appeal from the decision was quashed, 2018 ONCA 88).

31 Ibid [72].

32 Ibid [63]-[64].

(2) the access to justice facilitated by the TPF agreement must be substantively meaningful;

(3) the agreement must be a fair and reasonable agreement that facilitates access to justice while protecting the interests of the defendants; and

(4) the third party funder must not be overcompensated for assuming the risks of an adverse costs award because this would make the agreement unfair, overreaching and champertous.

Australia

In Australia, the legitimacy of third-party funding arrangements was established in the 1996 decision of the Federal Court of Australia in *Movitor Pty Ltd (receivers and manager appointed) (in liq) v Sims* (*Re Movitor*),[33] albeit in relation to the funding of insolvency proceedings.

This decision created the opportunity for commercial litigation funders to develop their business model in Australia as it allowed them to raise capital to provide funding to insolvency practitioners.[34]

Meanwhile, as had happened in the United Kingdom, there was legislative intervention in some States to expressly abolish maintenance and champerty as a crime and as a tort. Victoria was the first State to do so.[35] New South Wales followed in 1993,[36] as did other jurisdictions, although some appear to have abolished only one of either the crime or the tort.[37] In Queensland the tort has not been abolished expressly.

Again, similarly to the legislation in the United Kingdom, the relevant Australian statutory provisions were expressed

> … not [to] affect any rule of law as to the cases in which a contract is to be treated as contrary to public policy or as otherwise illegal, whether the contract was made before, or is made after, the commencement of this Act.[38]

Consequently, questions of maintenance and champerty are not to be regarded as always legally irrelevant. The section assumes that considerations of public policy and illegality can still arise in connection with contracts providing for or dealing with maintenance and champerty. The scope that might be given to public policy and illegality in this context was also explored by the High Court in *Fostif*. The Court held that third-party litigation funding arrangements, which involved a funder seeking out those who may have claims, and offering terms which not only gave the funder control of the litigation but also would yield significant profit for the funder, did not, either alone or in combination, constitute an abuse of process, or warrant condemnation as being contrary to public policy.[39] The majority said:[40]

> As Mason P 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 can 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 and the qualification of that rule (by reference to criteria of

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33 (1996) 64 FCR 380.

34 Ibid.

35 *Crimes Act* 1958 (Vic) s 322A; *Wrongs Act* 1958 (VIC) s 32(2).

36 *Maintenance, Champerty and Barratry Abolition Act* 1993 (NSW), subsequently repealed by the *Statute Law (Miscellaneous Provisions) Act* 2011. The abolition of the tort is preserved by Sch 2 of the *Civil Liability Act* 2002 and of the crime by Sch 3 to the *Crimes Act* 1900.

37 *Civil Wrongs Act* 2002 (ACT) s 221*; Criminal Law Consolidation Act* 1935 (SA), Sch 11; *Civil Liability Act* 2002 (Tas) s 28E.

38 *Maintenance, Champerty and Barratry Abolition Act* 1993 (NSW) s 6. This saving provision survives in s 2, Sch 2 of the *Civil Liability Act* 2002.

39 Ibid [88].

40 Ibid [89].

> common interest) proved unsuccessful. And if the conduct is neither criminal nor tortious, what would be the ultimate foundation for a conclusion not only that maintaining as action (or maintaining an action in return for a share of the proceeds) should be considered as contrary to public policy, but also that the claim that is maintained should not be determined by the court whose jurisdiction is otherwise regularly invoked?

The majority said there was no basis for the formulation of an overarching rule of public policy that would, in effect, bar the prosecution of an action where any agreement had been made to provide money to a party to institute or prosecute the litigation in return for a share of the proceeds of the litigation, or would bar the prosecution of some actions according to whether the funding agreement met some standards fixing the nature or degree of control or reward the funder may have under the agreement.[41]

This is very different from the position in the United Kingdom where the two factors that are likely to lead to a finding of champerty within the limits of the preservation contained in s 14(2) are:

(1) Where the funder takes control of the litigation out of the hands of the claimant and;
(2) If the funder is entitled to an excessive share of any recovery.

It is also different from the position in Canada where the agreement must demonstrably enhance access to justice and the funder must not be overcompensated for assuming the risk of the adverse costs order.

Although the decision in *Fostif* is unequivocal in its conclusion that, in Australia, funding arrangements of the type regularly entered into between funding entities and plaintiffs in class actions are enforceable and not contrary to public policy. What has not been settled unequivocally is the limit of the considerations of public policy and illegality in the context of the development of the securitisation of already funded litigation. In circumstances where a funder is trading in derivatives comprised of the potential proceeds of the class action, do such agreements fall within the description given by the Privy Council in *Ram Coondoo v Chunder Canto Mookerjee* as:

> .. extortionate and unconscionable, so as to be inequitable against the party; or to be made, *not with the bona fide object of assisting a claim believed to be just, and of obtaining a reasonable recompense therefor, but for inappropriate objects, as for the purpose of gambling in litigation*, or of injuring or oppressing others by abetting and encouraging unrighteous suits, so as to be contrary to public policy… (emphasis added).[42]

The securitisation of already funded litigation seems to meet the description of 'trafficking in litigation', which, although a difficult concept to define, connotes the 'unjustified buying and selling of rights to litigation where the purchaser has no proper reason to be concerned with the litigation'.[43] This type of arrangement, being a step from removed from the arrangement between the funder and the party funded, cannot transfer any property interest to which the causes of action are ancillary nor can any genuine commercial interest, in the sense explored in *Trendtex Trading Corporation v Credit Suisse.*[44] If these arrangements are indeed found to fall into a residual category of 'trafficking in litigation', they will not render the proceedings liable to dismissal or a stay but, at the very least, the securitisation agreements are likely to be unenforceable.

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[41] Ibid [91].

[42] *Ram Coondoo v Chunder Canto Mookerjee* (1876) LR 2 App Cas 186, 210.

[43] *Stocznia Gdanska SA v Latreefers Inc (No 2)* [2001] 2 BCLC 116 [61].

[44] *Trendtex Trading Corporation v Credit Suisse* [1982] AC 679, 703.

IV. THE OVERARCHING PRINCIPLES OF THE PROPOSED RECOMMENDATIONS

Against this background, I turn to consider the overarching principles by which the ALRC has been guided in formulating its proposed recommendations.

Principle One: It is essential to the rule of the law that citizens should be able to vindicate just claims through a process characterised by fairness and efficiency to all parties, that gives primacy to the interests of the litigants, without undue expense or delay.

Principle Two: There should be appropriate protections in place for litigants who wish to avail themselves of the class action system and the variety of funding models that facilitate the vindication of just claims.

Principle Three: The integrity of the civil justice system is essential to the operation of the rule of law.

Principle One

The basis of the introduction of the federal class action regime by Part IVA of the FCA Act was that it is essential that appropriate procedures exist to ensure that groups of persons who have suffered loss or damage, whatever the type of claim, will be able to pursue redress and to do so more cheaply and efficiently than would be the case with individual actions. Twenty-six years later, it is beyond doubt that, as was intended, the regime has enabled claims to be brought by people with small claims whose number may be such as to make the total amount at issue significant, and to deal efficiently with similar individual claims that are large enough to justify individual actions.

Enhanced powers of the Court

The transaction costs of class actions remain very high. Indeed, several recent settlement approvals have seen returns to the class of significantly less than 50% of the total settlement.[45] It is essential that court processes maximise efficiency and control expense and delay, without compromising fairness to any party.

Costs and delay are also necessarily increased where multiple class actions are commenced with respect to the same or related matters. In 2015-2016, 25% of class action proceedings were related actions.[46] Costs and delay are exacerbated when procedural 'arbitrage' emerges whereby parties seek to commence competing class actions in the same matter in different courts.[47]

The proposed Recommendations that respond to these issues include:

1. conferring an express statutory power on the Federal Court to reject, vary, or amend the terms in third-party funding agreements and to reject, vary, or amend the terms of any percentage-based fee agreement.
2. conferring an express statutory power on the Federal Court to deal with competing class actions and consequential amendments to the Class Action Practice Note.
3. amending the Class Action Practice Note to expressly include a clause that the Court may appoint a referee to assess the reasonableness of costs charged at any time during the proceedings.

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45 See for example: *Caason Investments Pty Ltd v Cao (No 2)* [2018] FCA 527 (30%); *Clarke v Sandhurst Trustees Limited (No 2)* [2018] FCA 511 (39%); *HFPS Pty Ltd (as Trustee for the Facility Project Hunter Services Pty Ltd Superannuation Fund) v Tamaya Resources Ltd (in liq)(No 3)* [2017] FCA 650 (29%).

46 King & Wood Mallesons, 'The Review – Class Actions in Australia 2015/2016'.

47 See *Wigmans v AMP Ltd* [2018] NSWSC 1045; *Wileypark Pty Ltd v AMP Limited* [2018] FCAFC 143.

4. amending the Class Action Practice Note to include a clause that the Court may adopt a tender process for settlement administration.
5. amending s 37N and s 43(3) of the *Federal Court of Australia Act* to expressly empower the Court to award costs against third-party litigation funders and insurers who fail to comply with the overarching purposes prescribed by s 37M.

Facilitating a broad range of redress options

Appropriate procedures to ensure that groups of persons who have suffered loss or damage will be able to pursue redress and to do so more cheaply and efficiently than would be the case with individual actions should not only facilitate access to the courts but should also provide for methods, where appropriate, of pursuing collective redress without resorting to litigation.

The proposed recommendation that responds to this issue is:

> That the Australian Government consider establishing a federal collective scheme that would enable corporations to provide appropriate redress to those who may be entitled to a remedy, whether under the general law or pursuant to statute, by reason of the conduct of the corporation. Such a scheme should permit an individual person to remain outside the scheme and to litigate the claim should they so choose.

Permitting a broader range of financing options

Regardless of the quality of procedures that give citizens the right to pursue claims, such rights are of little value if those citizens are unable to afford to pursue those claims. Litigation funding is an important element in facilitating access to the legal system, particularly in jurisdictions with cost shifting rules. Third-party litigation funding is now well established in Australia but, over the past five years, has predominantly facilitated access to the courts in a narrow range of claims, namely securities and investor class actions.[48] However, litigation funding is but one element in facilitating access to the courts to enable groups of persons to seek redress.

It is also common for solicitors representing plaintiffs in a class action to bill the representative plaintiff pursuant to a conditional fee agreement, otherwise known as a 'no win/no fee' agreement. More recently, After-the-Event (ATE) Insurance has provided another source of funding for plaintiffs in class actions. ATE insurance refers to a policy of insurance taken out after a dispute has arisen that generally covers the litigating party against its potential liability to pay adverse costs, as well as the party's own disbursements, in the event that the claim is unsuccessful. Typically, such policies are entered into in conjunction with a conditional fee agreement between the representative plaintiff and his or her solicitor. They are also used increasingly by litigation funders to offset a portion of the funder's risk.

Broadening the base of permissible funding models and creating different funding options may facilitate greater access to redress procedures, particularly in lower value claims or public interest matters, thereby assuring citizens are able to vindicate just claims consistent with the rule of law.

The proposed Recommendations that respond to these issues include:

1. the limited introduction of contingency fees – confined to the solicitors acting for the representative plaintiff in class action proceedings – and subject to the following limitations:

[48] Of the 71 funded claims filed in the Federal Court from 2013 to 2018, 52.1% (37) were claims by shareholders, and 23.9% (17) were claims by investors. This compares with 5.6% (4) four consumer protection and product liability class actions that were funded, and 4.2% (3) mass tort claims.

- contingency fee agreements are permitted only with leave of the Court;
- an action that is funded through a percentage-based fee agreement cannot also be directly funded by a litigation funder or another funding entity which is also charging on a contingent basis;
- a percentage-based fee cannot be recovered in addition to professional fees for legal services charges on a time-cost basis;
- solicitors who enter into a percentage-based fee agreement must advance the costs of disbursements (which are not to be included in the sum on which the percentage-based fee is calculated) and must indemnify the representative plaintiff against an adverse costs order;
- the capital adequacy of a firm acting on a contingency fee basis should be assured through a statutory presumption that an order for security for costs will be made;
- any ATE insurance premium incurred by a solicitor who has entered into a percentage-based fee agreement is to be treated as a disbursement and is not to be included in the sum on which the percentage-based fee is calculated.

Principle Two

We have already seen that, over the course of the two and a half decades since the introduction of the class action regime in Australia, the number of class actions has grown steadily, but not exponentially. The most significant trend in the preceding five years is the rise in funded shareholder or securities class actions. In the period from September 2013–September 2016, every shareholder class action filed in the Federal Court was funded by a third-party litigation funder.[49]

Class action proceedings have traditionally been conducted in Australia by a small pool of law firms and funded by a small number of litigation funders. That landscape is changing. In the period from 2005-2008, there were 11 different law firms in filed class actions. In the period from 2014-2017, that number grew to 43.[50]

The number of litigation funding entities active in the Australian market has also increased with around 25 currently active in Australian litigation, including class actions.[51] These entities, both domestic and foreign, include publicly listed corporations, private companies, private equity firms, and hedge funds. Some retain significant capital on their balance sheets; others access capital in a variety of ways.

<u>Regulating litigation funders</u>

Despite offering a financial service, litigation funders are not required to hold a licence to operate in Australia. Tension exists between the perceived need for a licensing regime to ensure that litigation funders have the ability to meet their financial obligations (to indemnify the plaintiff in the event of an adverse costs order and to meet their commitment to fund the plaintiff's lawyer) and manage the conflicts that are inherent in any funding agreement, and the risk that a licensing regime may unnecessarily stifle competition amongst funders and thus artificially inflate the cost of funding.

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[49] Vince Morabito, 'Empirical Perspectives on 25 Years of Class Actions' in Damian Grave and Helen Mould (eds), *25 Years of Class Actions in Australia* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2017) [4.3.2].

[50] King & Wood Mallesons, 'The Review: Class Actions in Australia 2016/2017'.

[51] Augusta Ventures (Australia) Pty Ltd, Australian Funding Partners Ltd, Balance Legal Capital LLP, Burford Capital LLC, Calunius Capital LLP, Chancery Capital, Claims Funding Australia Pty Ltd, Comprehensive Legal Funding LLC, Grata Fund, Harbour Litigation Funding Ltd, IMF Bentham Ltd, International Justice Fund Ltd, International Litigation Funding Partners, Investor Claim Partner, Ironbark Funding, Litigation Capital Management, Litigation Funding Solutions, Litigations Lending Management Pty Ltd, Litman Holdings Pty Ltd (Agora Capital Corporation), Macquarie Specialised Investment Solutions, Omni-Bridgeway, Therium Group Holdings Ltd, Vannin Capital Ltd, Woodsford Litigation Funding Ltd.

The proposed Recommendations that respond to these issues involve:

1. amending the *Corporations Act (2001)* (Cth) to require third-party litigation funders (who are funding class actions) to obtain and maintain a 'litigation funding' AFSL, with associated minimum capital adequacy requirements.
2. exempting charitable/pro bono funders from the requirement to hold an AFSL.
3. ensuring existing mutual recognition of appropriately regulated foreign funders continues.
4. requiring third-party litigation funders should be required to join the Australian Financial Complaints Authority Scheme.

<u>Additional regulation within the legal profession</u>

Concerns have also been expressed about the depth of understanding within the legal profession as to the complexity of the conflicts of interest that may arise in the context of third-party funded class actions, particularly given the rapid increase of new entrants, both funders and solicitors, to the class action landscape.

It is important that there are appropriate protections in place for litigants involved in class actions, including passive class members who are nevertheless reliant on the representative plaintiff, and the solicitor acting for the representative plaintiff, to act in their interests.

The proposed Recommendations that respond to these issues include:

1. developing specialist accreditation (non-mandatory) and on-going CPD for solicitors who practise in class actions.

2. prohibiting a solicitor from having a financial interest in a funder who is also funding the action in which the solicitor is acting.

Principle Three

The class action regime that was created by Part IVA of the FCA Act is different in character from other forms of civil litigation. Class actions are not simply disputes between private parties about private rights. They frequently perform a public function by being employed to vindicate broader statutory policies such as disclosure to the securities market, prohibiting cartels, or fostering safe pharmaceuticals.[52]

In addition, class members are usually passive participants in the litigation who lack the ability or the incentive to monitor the litigation activities of those who act on their behalf, the representative plaintiff and the solicitors retained by that plaintiff. These peculiar circumstances are reflected in the Court's role in agreements to settle class actions. Again, unlike other forms of commercial litigation, an agreement to settle class action litigation has no legal effect unless and until it is approved by the Court. It has been observed by the Full Federal Court that, 'it assumes a role akin to that of a guardian, not unlike the role a court assumes when approving infant compromises'.[53]

In circumstances where the Court is placed in the position of serving in a role akin to a fiduciary for the class, and in circumstances where the legitimacy of the complex tri-partite relationship between

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[52] Legg, 'Class Actions, Litigation Funding and Access to Justice', Public Lecture addressing the *Victorian Law Reform Commission Consultation Paper, Access to Justice – Litigation Funding and Group Proceedings* (2017) 18.

[53] *ASIC v Richards* [2013] FCAFC 89 [8].

representative plaintiff, solicitor and funder has been endorsed by the High Court of Australia,[54] the integrity of the system through which class claims are pursued must be assured. The legitimate use of the Court's processes in a common enterprise of a commercial character to obtain mutual benefits for each of the group members, the funder and the solicitors should not be undermined by proceedings that disproportionately benefit the funder and solicitors, rather than the litigants. Both the public function of class actions and the private interests of the litigants must take priority over the interests of those whose role it is to provide the services necessary to participate in the system.

The following proposed Recommendations respond to these issues:

Notification to class members of potential conflicts

Amending the Class Action Practice Note

- so that the first notices provided to potential class members by legal representatives are required to clearly describe the obligation of legal representatives to avoid and manage conflicts of interest, and to outline the detail of any conflicts in that particular case, and
- to require administrators to report to the class on completion of the distribution of the settlement sum

Resolution of cross-jurisdictional arbitrage

A constitutionally valid mechanism needs to be developed to resolve competing cross-jurisdictional representative proceedings.

Ensuring the policy settings of the substantive law continue to be appropriate

The Australian Government should commission a review of the legal and economic impact of the availability of private causes of action for breach of the continuous disclosure obligations, regardless of intention or fault, contained in the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth).

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54 *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386.