

IMF (AUSTRALIA) LTD

Submission to the Productivity Commission: *Access to Justice Arrangements*

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CONFIDENTIAL APPENDICES WILL BE PROVIDED SEPARATELY TO THE COMMISSION.

1. Introduction

- 1.1 IMF (Australia) Ltd (“**IMF**”) is pleased to present these submissions to the Productivity Commission on its inquiry into access to justice issues in Australia’s civil justice system. As IMF’s business depends on facilitating access to justice for its clients, IMF and its funded claimants (both actual and potential) have a very real interest in the work of the Commission. IMF has limited its submissions to those recommendations on which it feels qualified to comment.
- 1.2 In this submission, IMF initially responds to the issues raised in chapters 2, 13 and 14 of the Commission’s Issues Paper, before making some general comments on potential reforms to the civil justice system. Questions raised by the Commission are highlighted as boxed headings in this submission.
- 1.3 IMF is Australia’s largest litigation funder. IMF listed on the Australian Securities Exchange in 2001 (specially to promote transparency in what was a new industry, and not just a new business in an established industry) and has a market capitalisation of around \$270m. IMF operates from offices in Sydney and Perth with smaller offices in Melbourne, Adelaide and Brisbane and, through a subsidiary (Bentham IMF LLC), in New York and Los Angeles. Information on IMF can be found on its website at www.imf.com.au.
- 1.4 The Commission’s terms of reference say:
- “The cost of accessing justice services and securing legal representation can prevent many Australians from gaining effective access to the justice system. For a well-functioning justice system, access to the system should not be dependent on capacity to pay and vulnerable litigants should not be disadvantaged.”*
- 1.5 The reality today is that access to justice is very much dependent on capacity to pay. Litigants face very high costs and serious financial risks (including adverse costs orders if they lose) if they wish to pursue or defend claims. These costs and risks, which are often difficult or impossible for litigants to predict in advance, are inherent in all litigation in Australia’s courts. They are, without doubt, serious barriers to access to justice and to the effective civil enforcement of Australia’s laws.
- 1.6 IMF has built its business around meeting some of the demand for funding from claimants with strong legal claims who lack the financial resources necessary to pursue their claims through the civil justice system. As IMF adopts stringent criteria by which it assesses claims for funding, currently less than 5% of applications IMF receives are funded. There is therefore a significant need for litigation funding. However, over the last 10 years IMF itself has funded claims brought by over 300,000 claimants and has made access to justice a practical reality for those claimants. IMF’s funding has helped to balance the playing field for its clients, who usually face opponents who are far larger and better resourced than they are. It has facilitated the enforcement of Australia’s continuous disclosure regime, trade practices, insolvency, financial services and competition laws.¹
- 1.7 IMF’s objectives are closely aligned with those of the claimants it funds: namely to achieve the just, quick, inexpensive and efficient resolution of claims through appropriate use of the civil justice system. However, the practical attainment of those objects is another matter.

¹ S H Lim, “Do litigation funders add value to corporate governance in Australia?” (2011) 29 C & SLJ 135 at 146: “As litigation funders are focused on maximising their returns on investments, they also have strong incentives to monitor corporate disclosures, share price movements and regulator inquiries in order to identify litigation that has the best prospects of success. Thus, litigation funders are acting as private enforcers of statutory causes of action as well as providing individual shareholders with the means and incentives to monitor corporate conduct.”

- 1.8 IMF provides funding for claimants' own legal fees and expenses (including counsels' fees, witness expenses and court costs), agrees to pay any adverse costs orders which might be made if the claims are unsuccessful and will supply any security for costs which the court may order IMF's clients to provide. As IMF stands behind its clients' potential financial obligations to defendants, IMF ensures that successful defendants in litigation it funds will be paid their recoverable costs. IMF is only paid if the claimants are successful.
- 1.9 In addition to funding, IMF provides other services to its clients. These include investigating the claims and the prospects of them being resolved by means other than litigation (such as by direct negotiation with the defendant or through alternative dispute resolution, such as mediation or expert determination). In funded class actions, IMF plays a key role in locating potential claimants and informing them of the opportunity to join the class action to enforce their rights. IMF also manages the litigation for its funded claimants (to a lesser degree with insolvency practitioners), which removes a significant burden and distraction from their shoulders. IMF negotiates litigation budgets with the claimants' lawyers, ensures so far as possible that the legal costs and strategies are proportionate to the sums at stake and gives instructions to the lawyers on a day-to-day basis (subject always to the claimants' rights to override IMF's instructions and the lawyers' paramount professional duties to the claimants). IMF assists the claimants on litigation strategy and attends and participates in settlement discussions.
- 1.10 In return for IMF's promise of funding, claimants assign to IMF a share of any damages or settlement proceeds that are recovered from the opposing parties to their claims. The assignment includes reimbursement of all amounts IMF has paid, a project management fee (which is a percentage of the legal budget) and a percentage of the recoveries (typically in a range of 25 – 40% depending on claim size, resolution sum, expected duration to resolution and risks undertaken). IMF is paid nothing if the claims are unsuccessful (and, in fact, will likely have to pay a substantial adverse costs order).
- 1.11 As mentioned above, IMF has provided funding to more than 300,000 clients, who include private individuals, small businesses, superannuation funds and other institutional investors, churches, councils and charities and insolvency practitioners. In addition to funding litigation in Australia, IMF is or has funded litigation in New Zealand, Singapore, the United Kingdom, the Netherlands, South Africa and the United States.
- 1.12 Many critics suggest that litigation funding does not provide access to justice as the backbone of many class actions are the "large institutions". This is a misapprehension based on a lack of knowledge as to the type of institutions which join Australian class actions. These institutions are often managed funds, large superannuation trustees or nominee companies for numerous investors. These institutions do not have a mandate or separate financing to pursue claims for loss or damage suffered by their clients.
- 1.13 Prior to the emergence of litigation funding these institutions rarely, if ever, commenced litigation or joined class actions. If and when class actions are settled or proceed to judgment and money flows to these institutions, the money is either attributed to the members' funds or is distributed to the individual members. The actual number of direct and indirect clients of IMF is thus multiples of the 300,000 figure referred to above.
- 1.14 IMF funds three broad types of litigation:
 - (a) single party disputes which include general commercial disputes, claims against estates and trustees, building and construction disputes, patents, professional indemnity claims, contract disputes and claims against insurers;

- (b) insolvency proceedings, including claims for insolvent trading, preferences and breach of directors' duties; and
 - (c) multi-party litigation, including class actions against the banks over unfair penalty fees, securities class actions, cartel claims, claims against the issuers and raters of collateralised debt obligations and other complex credit products and claims involving the provision of financial services.
- 1.15 A single-party litigation funding agreement, as used by IMF, will be provided on a confidential basis for the Commission's information as will an overview of the typical arrangements between IMF, a funded claimant and the lawyers.
- 1.16 IMF applies strict investment criteria when deciding which cases to fund and whether to continue funding. IMF will only fund claims which have strong prospects of success, are against defendants with a verifiable capacity to pay any likely judgment, are liable to be proved primarily by reference to objective written evidence rather than potentially contested oral evidence and are likely to be resolved for not less than \$5m for single party matters or \$30m for multi-party litigation.² If it becomes clear that these criteria are no longer satisfied in a piece of funded litigation, IMF may cease funding that litigation. If IMF does so, IMF pays all of the claimant's legal costs and any adverse cost orders for costs incurred by the defendant during the period IMF was funding the litigation.
- 1.17 IMF does not fund certain categories of claims, including claims arising in the family law, personal injury, defamation and criminal areas.
- 1.18 To 30 June 2013, IMF had commenced and resolved 149 funded cases with an average investment duration of 2.3 years. Of those 149 cases, 95 were settled, 14 went to judgment or on appeal and were won, 5 were lost and IMF withdrew from 35.³ IMF and its clients were not required to pay any adverse costs orders in relation to the claims from which IMF withdrew its funding.
- 1.19 From these results, IMF generated revenue of \$1.28bn of which \$849m (66%) has been paid to IMF's clients, \$148m (12%) has been used in reimbursing IMF's costs (principally in paying the lawyers' fees and disbursements incurred in prosecuting clients' claims) and \$281m (22%) represents revenue to IMF after deduction of litigation costs paid by IMF. Lost cases cost IMF \$3.2m and cases from which IMF withdrew funding before resolution a further \$3.7m, in each case less than 1% of revenue. IMF has historically generated an average 290% gross return on funds invested.⁴
- 1.20 As at 30 June 2013, IMF had net assets of \$125.5m, of which \$68m was held in cash. As at 30 September 2013, IMF had investments in 28 claims with an estimated claim value of \$1.68bn. Claims worth in excess of \$50m (essentially large multi-party claims) accounted for 81% of the total portfolio value.⁵ IMF's net profit after tax in the 2013 financial year was \$13.8m.

2. The Importance of Access to Justice

- 2.1 The importance of ensuring equitable access to justice for all seems to be self-evident in a democratic society, such as Australia's, which is subject to the rule of law. In the *Fostif* decision of the High Court, which confirmed that litigation funding was not contrary to public policy, Kirby J referred to access to justice "as a fundamental human right which ought to be readily available

² J Walker, S Khouri and W Attrill, *Funding Criteria for Class Actions*, (2009) 32 UNSW LJ 1036.

³ IMF (Australia) Ltd, 2013 Annual Report, 3; Appendix 1.

⁴ IMF (Australia) Ltd, ASX Spotlight Conference, 15.

⁵ IMF (Australia) Ltd, Release to Australian Securities Exchange ("ASX"), Case Investment Portfolio as at 30 September 2013 (7 November 2013).

to all”.⁶

- 2.2 In giving the 18th Oration in Judicial Administration to the Australian Institute of Judicial Administration, the Hon. Wayne Martin AC, Chief Justice of Western Australia, referred to work by Professor Judith Resnik which:

“suggests that the civil courts provide a fundamental element of a democratic society, by providing a forum in which individuals and the State can present arguments in public as equals, and have those arguments adjudicated by an independent arbiter.”

Martin CJ went on to say that:

“It is undoubtedly true in theory that in a liberal democracy like ours, all individuals and the State have equal access to the courts. However, practical access is somewhat different, given the intellectual and financial resources required to participate effectively in the court process.”⁷ (emphasis added)

- 2.3 The Report by the Access to Justice Taskforce of the Attorney-General’s Department in September 2009 argued that “access to justice is an essential element of the rule of law and supports democracy”⁸, that “continuing improvements in access to justice are important to maintaining a strong rule of law”⁹ and that “maintenance of the rule of law is fundamental to Australia’s economy and prosperity.”¹⁰ The Taskforce referred to research that “improvements in governance that increase the rule of law in a country can be linked to increases in per capita GDP.”¹¹
- 2.4 That general accessibility to the civil justice system is correlated with economic growth and productivity is hardly surprising. As Lord Neuberger, the President of the UK’s highest court, the Supreme Court, recently observed (extra-judicially):

“Economic activity, productivity and innovation will only thrive, as Adam Smith explained more than two centuries ago, in an environment which affords secure property rights and effective freedom of contract. Investors need to know that the political elite will not expropriate their profits or their businesses at will. Individuals and businesses have to be able to enforce contracts, to protect their intellectual property and to obtain effective redress not merely against other individuals and businesses, but also against the State. To that end, the State has to provide fair and clear laws equally applicable to all, a legal system readily available to all, and an effective and efficient court structure readily accessible to all. It must, in other words, secure the rule of law.”¹²

- 2.5 Lord Neuberger referred to funding (from all sources) as the “life-blood of the justice system”¹³ and approved of Jeremy Bentham’s attacks on medieval doctrines of maintenance and champerty, which were developed to protect the integrity of the English judicial system from over-bearing barons but which prevented the development of third party funding for hundreds of years, in these terms:

⁶ *Campbells Cash and Carry Pty Limited v Fostif Pty Limited* (2006) 229 CLR 386, 451.

⁷ The Hon. Wayne Martin AC, 18th AIJA Oration – *Managing Change in the Justice System* (Brisbane, 14 September 2012), 11.

⁸ Attorney-General’s Department, *A Strategic Framework for Access to Justice in the Federal Civil Justice System* (Canberra, 2009), 2.

⁹ *Idem.*

¹⁰ *Idem.*

¹¹ *Idem.*

¹² Lord Neuberger, “From Barretery, Maintenance and Champerty to Litigation Funding”, Harbour Litigation Funding First Annual Lecture, Gray’s Inn, 8 May 2013, 4.

¹³ *Ibid.*, 22.

“The idea, as Bentham had mockingly put it, that an English judge would care for ‘the swords of a hundred barons’ was beyond ridicule. As he said, restrictions against litigation funding were a ‘barbarous precaution’ born out of a ‘barbarous age’...”¹⁴

2.6 Thus Lord Neuberger said, again with reference to Bentham:

“...as long as litigation, access to the courts, remains expensive, then anyone who has a right that stands in need of vindication should be able to obtain funding from anyone willing to offer it on whatever terms it is offered. The public policy rationale is simple in his opinion: access to the courts is a right, and the State should not stand in the way of individuals availing themselves of that right.”

2.7 Strong access to justice in a society increases the likelihood that laws will be enforced, wrongdoing deterred and losses due to misconduct adequately compensated by the wrongdoers. This is particularly important in relation to laws designed to protect the interests of consumers or promote confidence in the integrity of public markets, due to these laws widespread economic and social importance. Often these laws are only practically capable of enforcement through a funded class action because individual losses are too small to justify pursuing alone.

2.8 Access to justice obviously does not require that all disputes should be resolved through the courts. Most disputes thankfully never receive judicial attention. However, many of the most important and difficult disputes which arise in our society do engage the civil justice system and this is the arena in which IMF operates. Our perspective is therefore that of a sophisticated and repeat user of the civil justice system, on the claimant's side. IMF's role for the claimant equates to that of the insurer for the defendant. Both types of funder, insurer and litigation funder, fund, manage and, to a degree, control the client's litigation pursuant to a contract very much sought after by the client.

2.9 In IMF's experience, ensuring adequate access to justice remains a serious challenge for the Australian legal system today. The most significant barriers to access to justice at the court level are undoubtedly the high cost of litigation, the unpredictability of both the final cost and the time involved in resolving the dispute and the very significant other financial risks inherent in using the courts, including the risk of adverse costs orders and the potential need to provide security for costs.

2.10 Most people of ordinary means and most businesses find the prospect of commencing litigation, even if they have a strong case, to be quite unthinkable. In Australia, potential claimants face not only the need to meet their own lawyers' costs, and in many instances to provide security for costs, but also a need to meet a substantial portion of the other side's costs if the case is lost. A well-resourced defendant can simply litigate a claimant into bankruptcy and even if the defendant's war of attrition can be endured, the financial consequences to the claimant if the case is lost can be ruinous.

2.11 Even wealthy individuals can find the cost of litigation daunting. One of Australia's richest men, Aussie Home Loans' founder and executive chairman, John Symond, severely criticised the legal system recently after winning a \$5m claim against a law firm for negligent tax advice. He told the *Australian Financial Review* that the litigation had cost him close to \$14m (for a number of years he was paying between \$100,000 and \$150,000 per month in legal fees), took 10 years to resolve and would have been impossible if he had not been wealthy. He said:

“It's a very poor legal system; not many people who are victims and take actions like this can financially survive . . . you've got to spend all the money first before the defendant spends any money, and the insurance companies are experts. They

¹⁴ Ibid 11.

know that probably nine out of ten will fall off along the way because they haven't got the financial resources."¹⁵

- 2.12 The Hon John Doyle AC, QC, former Chief Justice of the Supreme Court of South Australia, has gone so far as to declare that "the existing system for commercial litigation does not deliver effective justice."¹⁶ He identifies delay and cost as two key contributors to this failure:

"For many commercial litigants, probably for most, the risk on costs is a prohibitive risk. Alternatively, as the case progresses through the system, the litigant becomes desperate to escape the system. As the full implications of the costs risk emerge, the litigant decides that the costs risk is one that cannot be run. Settlement is driven to a substantial degree by costs. These figures ignore the cost of the parties' own time, and business costs.

In short, the cost of litigation to a party, and the risk that is run on a costs order, effectively drives people from the door of the court. For many, it is not business like to resort to commercial litigation because of the cost, time taken and risk. Access to the system is effectively denied, or parties "back out" because the risk has become prohibitive."¹⁷

- 2.13 In 2008, Lord Justice Jackson (a Judge of the Court of Appeal in London) was commissioned to conduct a review into civil litigation costs in England and Wales. Senior English judges were concerned about the increasing cost of civil justice, in particular that costs were often disproportionate to the importance of the issues being litigated. In his Final Report, published in January 2010, Jackson LJ zeroed in on the issue of cost as a barrier to access to justice (and the concomitant importance of funding for those costs):

"The present Governor of the Bank of England (following litigation in which the Bank was vindicated) has stated: "A legal framework for enforcing contracts and resolving disputes is not just an arcane process which allows professionals to earn vast fees, but an integral part of the infrastructure of a successful market economy. It matters that there are simple, clear and timely ways of resolving disputes." I agree with those comments.

Access to justice: Access to justice entails that those with meritorious claims (whether or not ultimately successful) are able to bring those claims before the courts for judicial resolution or post-issue settlement, as the case may be. It also entails that those with meritorious defences (whether or not ultimately successful) are able to put those defences before the courts for judicial resolution or, alternatively, settlement based upon the merits of the case.

Funding makes access to justice possible: Access to justice is only possible if both parties have adequate funding. If neither party has adequate funding, the litigation will not happen. If only one party has adequate funding, the litigation will be a walk over.

Proportionate costs make access to justice practicable: Access to justice is only practicable if the costs of litigation are proportionate. If costs are disproportionate, then even a well-resourced party may hesitate before pursuing a valid claim or maintaining a valid defence. That party may simply drop a good claim or capitulate to a weak claim, as the case may be.

¹⁵ H Low, 'Aussie Home Loans founder decries expensive legal system', *Australian Financial Review*, 1 November 2013, page 32.

¹⁶ The Hon. John Doyle QC, "Commercial Litigation and the Adversarial System – Time to Move On" (Paper presented at the Supreme Court of Victoria Commercial Law Conference – Current Issues in Commercial Law, Melbourne, 9 September 2013), 5.

¹⁷ *Idem*, 7.

Funding methods and costs rules impact upon each other: It is wrong to regard “funding” and “costs” as separate topics which must be tackled individually, in order to provide access to justice. They impact upon each other. Some methods of funding tend to drive up costs and some methods of funding have the opposite effect. Some costs regimes reduce the need for funding (e.g. one way costs shifting). Some costs regimes increase the need for funding (e.g. a regime that requires one party to pay double costs if it loses). Indeed the costs rules themselves constitute one form of funding regime, namely that the loser funds the winner.

Three linked concepts: Accordingly, the three concepts of access to justice, costs and funding are interlinked. It is unsurprising, indeed inevitable, that they are conjoined in my terms of reference.”

- 2.14 Governments around the world have long been concerned to rein in the growing cost of the legal system, so as to improve its accessibility to the public, while at the same time cutting legal aid budgets which had previously offered the means to at least some claimants to enter the system. The Commission’s work is part of this process and we suggest some broader reforms to the civil justice system in Part 6 of this submission which aim to achieve this result.
- 2.15 Litigation funding is a private market response to the demand for increased access to justice in a time of rising legal costs and falling public funding. As the Office of the Legal Services Commission in New South Wales has observed:

“Litigation funding can bring numerous social and economic benefits. Commercial funding for large group plaintiff actions is an effective market based solution for a public policy gap, that being a lack of cheap court access or public funding for such cases. There is no doubt that litigation funding allows people who otherwise couldn’t afford to claim to seek redress for real, and to them substantial, losses caused by the actions of others to do so.

Access to litigation funding for individual plaintiffs may also help to counterbalance the taxation advantages available to corporate defendants. Currently, most multi-party litigation concerns claims for damages for personal injuries brought on behalf of individuals against corporate defendants. Since the litigation relates to corporate business activities, the corporate defendant can claim all litigation expenses as a taxation deduction, effectively gaining a publicly funded subsidy.”¹⁸

- 2.16 However, as the Commission notes in its Issues Paper at page 36, litigation funding (and contingent billing) “are not without controversy.” In IMF’s submission much of the controversy that attaches to litigation funding is unfounded, contradictory, often agitated by lobby groups with an interest in denying access to justice or protecting vested interests and inconsistent with the evidence. There is one important exception: the regulation of Australian litigation funders, which IMF submits needs further attention, as is discussed below.

3. The Data Problem

- 3.1 In Chapter 14 of the Issues Paper, the Commission has raised the serious issue of the lack of adequate data with which to better understand the extent of the problem of access to justice and the performance of the civil justice system, including the use of private ADR processes. Data is required to formulate appropriate policy responses to address access to justice issues and to monitor and assess the effectiveness of those measures.

¹⁸ The Office of the Legal Services Commissioner (NSW), “The Regulation of Third Party Litigation Funding in Australia – Discussion Paper” (March 2012), 4 – 5.

- 3.2 A discussion of the full range of data that might usefully be collected on the civil justice system is beyond the scope of this submission. However, IMF would like to address two areas of particular relevance to its interaction with the civil justice system – namely data on the incidence and impact of commercial litigation in Australia and data on the extent of litigation funding effectively provided by insurers to Australian litigants (primarily defendants).
- 3.3 As a public listed company, IMF publishes extensive information on its operations. IMF's litigation funding statistics, which stretch back over 10 years, are one of the most important, credible and transparent sources of data on litigation funding in the world. In May 2011, IMF supplemented information provided in its ASX-disclosures by publishing audited statistics on the 118 matters it had funded and finalised since its listing on 19 October 2011 to 31 December 2010. IMF has recently updated this information to 30 June 2013 for 149 finalised cases. A copy of the updated information is Appendix 1 to this submission.
- 3.4 Reference should also be made to Professor Morabito's comprehensive empirical study of class actions in Australia,¹⁹ which included an analysis of funded class actions to March 2009. This work has provided valuable insights into class action litigation in Australia since the introduction of Part IVA to the Federal Court of Australia Act 1976 (C'th) in March 1992 and has debunked a number of myths surrounding funded class actions (as discussed later in this submission).
- 3.5 However, IMF's data provides only a partial insight into the Australian litigation funding market, as it may impact access to justice. Statistics need to be collected and published on the performance of all commercial litigation funders and on insurers' funding of defence costs, as insurers are another, far larger, source of funding for litigation (albeit on the defendants' side).
- 3.6 This data, which should be collected centrally and be de-identified, would include:
- (i) the number and type of completed claims funded by each funder and the number and type of completed defended claims funded by each insurer (we have suggested this information be collected after a claim is resolved as it will be more accurate and not subject to change);
 - (ii) the cost of the litigation to the funders, insurers, claimants and the Courts;
 - (iii) the amounts at which the funded parties were prepared to settle each case, the stage in the litigation at which the settlement was reached, and value of the claims being compromised; and
 - (iv) the value of any judgments for claims that did not settle, the result of any appeals, and the time each proceeding took to resolve.
- 3.7 This data could produce some surprising statistics. For example, it is acknowledged by members of the insurance industry that about 75 cents in every dollar paid out by insurers on directors and officers' policies goes in the cost of defending the claims, with only 25 cents going to the claimants. This type of statistical data was relevant in the tort reform debates some years ago and must be relevant to civil justice reform focusing on access to justice.
- 3.8 Further, if the government was prepared to identify how many individuals and organisations in Australia could afford to meet the cost and assume the risks of medium to large scale civil litigation, IMF believes that the percentage would be negligible.

¹⁹ V Morabito, "An Empirical Study of Australia's Class Action Regimes – Second Report – Litigation Funders, Competing Class Actions, Opt Out Rates, Victorian Class Actions and Class Representatives" (Australian Research Council, September 2010).

4. Litigation Funding as a Facilitator of Access to Justice

The Legal Status of Litigation Funding

- 4.1 As Michael Legg has observed, as a result of the majority's decision in 2006 in the High Court in *Fostif*²⁰ litigation funding "went from pariah to an accepted part of civil litigation."²¹
- 4.2 Prior to *Fostif*, the development of litigation funding had been inhibited by uncertainty over the extent to which medieval prohibitions on maintenance and champerty still held sway in Australian law.
- 4.3 Maintenance involves the provision "without lawful justification" of financial assistance to a person to bring or defend civil proceedings and champerty is an aggravated form of maintenance in which the maintainer agrees to receive a share of the proceeds of the action. Originally the prohibitions were developed to protect the weak and developing justice system from abuse wrought by rich and powerful feudal lords. But in time they came to have the opposite effect: in the words of Jeremy Bentham, they gave wealth the "monopoly of justice against poverty".²²
- 4.4 *Fostif* concerned New South Wales' law. New South Wales had abolished, by statute, maintenance and champerty as torts and crimes, but had exempted "any rule of law as to the cases in which a contract is to be treated as contrary to public policy or otherwise illegal." *Fostif* established (by a 5:2 majority) that the litigation funding arrangements in that case were neither an abuse of the court's process nor otherwise illegal.
- 4.5 The plurality in the High Court, Gummow, Hayne and Crennan JJ (with whom Gleeson CJ and Kirby J concurred), said:

"Shorn of the terms of disapprobation, the appellants' submissions can be seen to fasten upon Firmstones' seeking out those who may have claims, and offering terms which not only gave Firmstones control of the litigation but also would yield, so Firmstones hoped and expected, a significant profit to Firmstones. But none of these elements, alone or in combination, warrant condemnation as being contrary to public policy or leading to any abuse of process.

As 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 could be condemned as contrary to public policy only if a general rule against the maintenance of actions were to be adopted. But that approach has long since been abandoned . . . And if the conduct is neither criminal nor tortious, what would be the ultimate foundation for a conclusion not only that maintaining an 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 otherwise is regularly invoked?"²³ (emphasis added)

- 4.6 Their Honours went on to consider two fears associated with litigation funding: fears about possible adverse effects on the litigation process and fears about the fairness of the bargain

²⁰ (2006) 229 CLR 386.

²¹ M Legg, *Case Management and Complex Civil Litigation* (The Federation Press, 2011), 231.

²² Lord Neuberger, note 12, 15.

²³ (2006) 229 CLR 386, 433 – 434 per Gummow, Hayne, Crennan JJ.

struck between the funder and the client. They concluded that: “To meet these fears by adopting a rule in either form would take too broad an axe to the problems that may be seen to lie behind the fears.”²⁴

- 4.7 They rejected a role for the courts in assessing whether a funding agreement was “fair” as this assumed, wrongly, that “there is some ascertainable objective standard against which fairness is to be measured and that the courts should exercise some (unidentified) power to relieve persons of full age and capacity from bargains otherwise untainted by infirmity.”²⁵ And in response to Lord Denning MR’s oft-repeated warning in *In re Trepca Mines Ltd (No 2)*²⁶ that the “common law fears that the champertous maintainer might be tempted, for his own personal gain, to inflame damages, to suppress evidence, or even to suborn witnesses”, the majority replied:²⁷

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

- 4.8 The plurality recognised the practical reality of multi-party litigation and the positive role that funding can play in this regard. Underpinning their judgment was a determination to ensure that the defendants were not able to take advantage of “some general rule of public policy that a defendant may invoke to prevent determination of the claims that are made against the defendant.”²⁸

- 4.9 It is important to note that the High Court’s approval in *Fostif* extended to a funder (not IMF) who:

- sought out the claimants through an extensive advertising campaign;
- organised and initiated the proceedings;
- gave all instructions to the solicitors in relation to the conduct of the proceedings;
- had the power to settle the claims (provided the settlement was not less than 75% of the amount claimed);
- agreed to pay all legal costs, any adverse costs orders and provided \$1m in security; and
- would receive up to a third of any recoveries plus all costs awarded to the claimants.

- 4.10 Since *Fostif*, litigation funding as a means of improving access to justice has received broad acceptance by the courts in numerous decisions (including by the High Court in a subsequent decision on litigation funding²⁹ and in the approval granted to litigation funders’ fees in a number of funded class action settlement approvals in the Federal Court), and by the Australian government and regulators.³⁰

²⁴ (2006) 229 CLR 386, 433 – 434 per Gummow, Hayne, Crennan JJ.

²⁵ Ibid, 434.

²⁶ [1963] Ch 199 at 219-220.

²⁷ (2006) 229 CLR 386, 435.

²⁸ Idem.

²⁹ *Jeffrey & Katauskas Pty Ltd v SST Consulting Pty Ltd* (2009) 239 CLR 75.

³⁰ For a discussion of judicial decisions dealing with litigation funding, both pre – and post – *Fostif*, see D Grave, K Adams and J Betts, *Class Actions in Australia* (2nd ed, 2012), 803 – 816. IMF’s funding of two of the recently settled class actions

- 4.11 The Courts have also recognised the benefits a funder can bring to the efficient administration of justice. French J (as he then was) made this point when rejecting an argument that funding by IMF in the case before him was an abuse of the court's process:

“The development of arrangements under which the cost risk of complex commercial litigation can be spread is at least arguably an economic benefit if it supports the enforcement of legitimate claims. Where such arrangements involve the creation of budgets by funders knowledgeable in the costs of litigation it may inject a welcome element of commercial objectivity into the way in which such budgets are framed and the efficiency with which the litigation is conducted. The formulation of a budget limiting the amount of funding provided is, of course, different from the assumption by the funder of control of the conduct of the litigation. The Court is in no position to pass definitive judgments on questions of the overall economic benefits to be derived from legitimate litigation funding arrangements. But the development of modern funding services in commercial litigation may be seen as indicative of a need in the market place to which those developments are legitimate responses. It is not for the Court to judge them as contrary to the public interest unless it be shown that a particular arrangement threatens to compromise the integrity of the Court's processes in some way.”³¹

The Litigation Funding Market in Australia

- 4.12 The market for the provision of litigation funding to litigants in Australia is fully contestable, in the sense that there are no regulatory barriers to entering the market. Regulation is currently limited to a requirement that funders have adequate procedures for managing conflicts of interest. There are no minimum capital requirements or licenses required to establish a funding business in Australia. Anyone, with the possible exception of a law firm seeking to fund litigation in which it acts (this issue is currently before the Federal Court), can establish a litigation funding business in Australia. As one would expect, the market has become more competitive over time.

- 4.13 The Australian market currently consists of a number of well-established local funders and has also witnessed the arrival of a number of overseas' based funders in recent years. Presently the market includes:

- IMF.
- Hillcrest Litigation Services Limited (another ASX-listed funder, though much smaller than IMF).
- Two domestic funders that specialise in insolvency actions – LCM Litigation Fund Pty Ltd and Litigation Lending Services Limited (“LLS”) (LLS is also funding a class action against banks in New Zealand).
- Claims Funding Australia Pty Ltd (“CFA”) – a funder established by the plaintiff law firm Maurice Blackburn which is seeking Federal Court approval for CFA to part fund a class action being run by Maurice Blackburn. If the Court grants Maurice Blackburn's application, the way will be clear for lawyers in Australia to effectively side-step the

against Centro group companies and their auditors, was approved by the Federal Court in *Kirby v Centro Properties Ltd (No 6)* [2012] FCA 650. See also the Hon Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, “Government acts to ensure Access to Justice for Class Action Member” (Media Release, 4 May 2010), announcing the Government's decision to draft regulations clarifying that funded class actions are not managed investment schemes (thereby reversing the decision of the Full Federal Court in *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2009] FCAFC 147). The Minister said: “There were serious concerns about impeding access to justice for small consumers, if access to funded class actions were to be subject to the same regulatory requirements as managed investment schemes under the *Corporations Act*.”

³¹ *QPSX Limited v. Ericsson Australia Pty Limited (No. 3)* [2005] FCA 933, [54].

prohibition on lawyers charging contingency fees by providing funding to their clients through a funding business established by the lawyers. If so, lawyers will potentially become direct competitors with third party funders. This is discussed further below.

- A number of non-Australian funders, including Comprehensive Legal Funding LLC (a US-based funder that works closely with Slater & Gordon), International Litigation Funding Partners Pte Ltd (a Singapore-based funder), Omni Bridgeway (a Dutch funder which provided funding for the Abalone class action conducted by Maurice Blackburn), and Argentum Investment Management Limited (which is based in the UK, announced its entry into the Australian market in March 2012 and is seeking to co-fund a major class action with CFA).

4.14 Increased competition can be expected in the future. Australasia is becoming increasingly attractive to UK-based funders and insurers seeking to provide adverse cost insurance. In addition to Argentum, in August 2011 the UK's leading litigation funder, Harbour Litigation Funding, announced that it had agreed to fund the *Feltex* multi-party litigation in New Zealand.³²

Litigation Funding and Access to Justice – General Comments

4.15 The capacity of litigation funding to significantly impact access to justice issues has been questioned. One of the authors of these submissions summarised the arguments in a chapter on the future of litigation funding as follows:³³

“Critics of litigation funding as a means of improving access to justice commonly raise three objections. The first argument is that funders are selective. They reject meritorious cases that do not meet their investment criteria, such as small claims and claims for non-monetary relief. And they insist on ‘closed classes’ in funded class actions, thereby excluding potential group members who have not signed a funding agreement.³⁴ The second argument is that as the number of funded cases is low compared to the level of litigation in the courts, the impact of litigation funding on access to justice is, at best, ‘modest’.³⁵ The third argument is that the courts are no place for ‘suits that are bought only because a trader can make a profit from the exercise’.³⁶

As to the first of these concerns, funders’ case selection criteria are indeed strict and exclusionary.³⁷ No system of funding for litigation anywhere in the world, whether publicly or privately funded, accepts (or can accept) all cases brought to it. Funders prefer to fund closed classes in representative proceedings so as to prevent ‘free riders’ (people who will benefit from the proposed action but do not agree to contribute towards its cost) from eroding funders’ returns to the point where the litigation is uneconomic to fund. Funders have long advocated reforms to address this issue.”³⁸

³² H Fletcher, “British law firm backs Feltex Claimants”, *The New Zealand Herald* (Auckland, 13 August 2011) http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10744786

³³ W J Attrill, “Chapter 16: The Future of Litigation Funding in Australia” in M Legg (ed), *The Future of Dispute Resolution* (2013), 168 -169.

³⁴ Grave et al, note 30, 836–840.

³⁵ *Ibid*, 802.

³⁶ P A Keane, ‘Access to Justice and Other Shibboleths’, paper presented to the JCA Colloquium, Melbourne, 10 October 2009, 3.

³⁷ J Walker, S Khouri and W Attrill, note 2.

³⁸ In 2007, IMF proposed reforms that would allow representative applicants in an ‘open class’ class action to seek an order from the court, at the outset of the proceedings, that the funder’s returns from the proceedings (if successful) be paid by all group members pro rata to their share of any settlement or damages award: J Walker, ‘The Changing Funding Environment in Class Actions’, paper presented at the Maurice Blackburn International Class Actions Conference, Sydney, 2007, 8–9.

As to the second argument, it is also true that the number of funded actions is relatively small. Australia's largest funder, IMF (Australia) Ltd (IMF), has only resolved 123 cases in 10 years (although some of these are very large class actions),³⁹ which hardly compares to the vastly greater level of litigation in the courts.⁴⁰ However, none of the funded cases would have been brought without IMF's support and the number of claimants who have been assisted by litigation funding is very large. Professor Morabito has estimated approximately 70,500 persons were group members of 18 funded class actions he studied, with about 5,500 persons entitled to share in the recoveries from settled funded cases.⁴¹ IMF is funding litigation against major Australian banks for around 170,000 bank customers.⁴² Each funded case is of importance to the claimants involved.

*The third argument turns on the view one takes of the proper role of the civil justice system. The courts are undoubtedly an arm of government with a constitutional duty to quell controversies brought before them and are not commercial markets for trading in litigation. But to suggest that funders undermine the purity of justice mischaracterises their role and influence, discounts the power of courts to control their own process and ignores other important and practical issues that affect access to justice. Justice Kirby in *Fostif* put another view:*

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' proceedings⁴³ ... A litigation funder ... does not invent the rights. It merely organises those asserting such rights so that they can secure access to a court of justice that will rule on their entitlements one way or the other, according to law."⁴⁴

- 4.16 Litigation funding is an important element in improving access to justice. Its importance has perhaps been best summarised in an article on the evolution of class action litigation in Australia as follows:

"Access to justice is undeniably a central aim of class action legislation, and commercial funding is no panacea for that objective. However, a robust commercial litigation funding market does represent a positive step towards its attainment."⁴⁵

What are the benefits of Litigation Funding?

- 4.17 Litigation funding can bring numerous benefits to the civil justice system, including:⁴⁶

- Improving access to justice: litigation funding's capacity to improve access to justice for claimants with the types of cases that are suitable for litigation funding has been discussed above and is discussed further in the next section on funded class actions.

³⁹ IMF (Australia) Ltd, *2011 Annual Report*, 2011, Sydney, 4.

⁴⁰ For example, the Federal Court of Australia reported 4,303 new matters (excluding appeals) were commenced in the court in 2010–11 and 4,036 were resolved in that year: Federal Court of Australia, *Annual Report 2010–2011*, Canberra, 2011, 129.

⁴¹ V Morabito, note 19, 39.

⁴² IMF (Australia) Ltd and Maurice Blackburn, *Bankwest Customers Take Class Action on Unfair Fees*, media release, 18 April 2012.

⁴³ (2006) 229 CLR 386, 451.

⁴⁴ *Ibid*, 468.

⁴⁵ B Murphy and C Cameron, "Access to Justice and the Evolution of Class Action Litigation in Australia," 30 *Melb U L Rev* 399, 439.

⁴⁶ See, e.g., the discussion in D Grave, K Adams and J Betts, note 30, 794–798.

- “Levelling the playing field” by providing under-resourced claimants with the financial backing necessary to deal on a equal footing with large, well-resourced defendants. Litigation funding from an organisation like IMF practically eliminates the ability of a defendant to out-spend and bankrupt a claimant, rather than satisfactorily and fairly resolve the claim.
- Improving the enforcement of consumer protections and other statutory norms, including the continuous disclosure, competition and financial services laws, informing people affected by breaches of those laws of their rights, delivering substantial compensation to them, improving the efficiency and fairness of public markets, indirectly raising standards of corporate governance and enhancing deterrence.⁴⁷
- Improving the efficient administration of justice through the funder’s role as an experienced and expert repeat user of the civil justice system, both in relation to the management and control of legal costs and the more effective prosecution of the litigation. In addition, the funding of class actions improves judicial efficiency through allowing issues common to the rights of numerous individuals to be adjudicated in a single hearing.
- Providing better cost protection for defendants, where the funder undertakes to pay any adverse costs order if the funded litigation is unsuccessful. (This benefit could be enhanced if prudential supervision of funders was introduced to ensure they have adequate capacity to meet their likely financial commitments.)

Does Litigation Funding Cause Excessive Levels of Litigation?

- 4.18 Self-evidently, litigation funding increases the amount of litigation in the courts. This is a consequence of increasing access to justice. In IMF’s experience, only a small percentage of the claims that IMF agrees to fund would have proceeded in the absence of IMF’s funding.
- 4.19 However, it is most unlikely that litigation funding increases the level of litigation in the courts to *excessive* levels. This is because the absolute number of funded cases is never more than a very small proportion of the total number of proceedings brought before the courts.
- 4.20 In a paper published in December 2011, Dr George Barker estimated that funded litigation constituted considerably less than 0.1% of the overall civil litigation market per annum in Australia.⁴⁸ Given the considerable barriers to access to justice the Commission is examining, it is possible that the level of litigation in Australia is actually socially sub-optimal, but it is not possible to reach any definitive conclusion in the absence of adequate data on the level of unlitigated and unresolved civil disputes.
- 4.21 Critics of litigation funding sometimes refer to a study carried out by American academics Abrams and Chen which seeks to empirically test aspects of the impact of third party funding on the court system in Australia.⁴⁹ The authors were provided with access to IMF’s claims data (funded and unfunded). Between August 2001 and June 2010 IMF had funded and completed 113 cases, the average length of which was 2.33 years. Thirteen of these cases resulted in a judgment (11.5%). The authors note that from February 1999 to June 2007, IMF decided to fund 90 out of 763 cases considered, a funding rate in this period of 11.8%.

⁴⁷ On the important role played by litigation funders in facilitating private enforcement of Australia’s continuous disclosure laws, see: J Mayanja, “Enhancing private enforcement of Australia’s corporate continuous disclosure regime: Why unshackling litigation funders makes eminent sense”, (2010) *Aust J of Corp Law* 48 and S H Lim, “Do Litigation funders add value to corporate governance in Australia?”, (2011) *C & SLJ* 135.

⁴⁸ G R Barker, “Third Party Litigation Funding in Australia and Europe” (Working Paper No 2, 2011), Centre for Law and Economics, ANU College of Law, 2011, 33. Dr Barker calculated IMF’s share of the civil cases lodged nationally in the Australian courts in a year at only 0.004%.

⁴⁹ D S Abrams and D L Chen, “A Market for Justice: A First Empirical Look at Third Party Litigation Funding” (January 2012) available at <https://www.law.upenn.edu/cf/faculty/dabrams/workingpapers/MarketforJustice.pdf>.

- 4.22 The authors carried out a series of regression analyses of data on the performance of the civil and criminal courts in Australia for the years 1994 to 2009 obtained from the Australian Reports on Government Services. They compared certain performance indicators of civil courts in jurisdictions in which IMF had funded claims to those of courts processing criminal matters in the same jurisdictions. The latter were effectively controls for the former since there is no litigation funding of criminal matters.
- 4.23 As a result of these analyses, the authors concluded that “overall, we see a pattern of increased funding leading to slower case processing, larger backlogs, and increased spending by the courts.”⁵⁰ Putting it another way, they said: “an increase in activity of litigation funders leads to more sclerotic courthouses”.⁵¹ The authors also calculated that “a 100% change in IMF expenditures would lead to a 10% decrease in [case] finalisations [in a year].”⁵²
- 4.24 The conclusions drawn from this study are not plausible given that in the *entire 9 year* period under review IMF funded and completed only 113 cases in all of Australia whereas according to the Report on Government Services 2011 (at 7.18) in 2009-10 *alone* over 36,000 new matters were lodged with the state Supreme Courts and the Federal Courts. As Dr Barker observes, referring to this study: “It seems unlikely that something affecting much less than 0.1% of the civil case load of courts in Australia could have any such effect so as to be noticeable.”⁵³ It seems much more likely that factors other than litigation funding were responsible for declines in the performance of the courts during this period. These might include government budget decisions which adversely affected the courts’ performance,⁵⁴ increases in the levels of all or certain types of litigation unrelated to funding or other factors.
- 4.25 It might be argued, however, that litigation funding leads to excessive levels of very large and complex pieces of litigation (the most obvious being funded securities class actions) that could “crowd out” other cases from the courts. However, this argument is not borne out by the evidence.
- 4.26 Professor Morabito’s extensive empirical study of class actions filed in the Federal Court since the introduction of the Part IVA regime in March 1992 and in the Supreme Court of Victoria since January 2000 (when Victoria adopted its own class action regime) has established that there has been no “explosion” in class actions in Australia, funded or otherwise. Professor Morabito’s key findings include:

“Dividing the first 17 years of Part IVA into four equal periods of four years and three months, we find an extremely limited use of this regime in the first quarter - from 4 March 1992 to 3 June 1996 - (37 proceedings), more extensive use from 4 June 1996 to 3 September 2000 (93 proceedings) and a decreasing number of Part IVA proceedings ever since: 65 from 4 September 2000 to 3 December 2004 and 54 from 4 December 2004 to 3 March 2009.”

“A total of 18 Federal class actions have been funded by five commercial litigation funders and one Victorian class action has been funded by one of these five funders. These litigation funders have provided class members with an indemnity with respect to adverse costs awards, including security for costs orders.”⁵⁵

⁵⁰ Ibid, 27.

⁵¹ Idem.

⁵² Ibid, 29.

⁵³ Note 48, 33.

⁵⁴ See, for example, the comment in the Federal Court of Australia’s Report 2012 – 2013, 12 : “In the five year period since 2008 - 09 the Federal Court’s caseload increased by fifty percent. This is at a time when the Court’s staffing decreased fifteen percent from 422 at the commencement of the 2008 – 09 financial year to 358 as at 30 June 2013.”

⁵⁵ V Morabito, note 19, 3, 5. Since March 2009 (the end date of Prof. Morabito’s Study), 7 shareholder class actions have been filed in Australia’s courts, 6 in 2011 and only 1 in 2012: Allens Linklaters, “Shareholder Class Actions in Australia” (August, 2013), 2.

- 4.27 In any event, there are numerous reasons, other than the advent of litigation funding or class actions, for the increasing frequency of large and complex cases (sometimes referred to as “mega litigation”) entering the Australian court system. Most of these cases are not funded (e.g. the massive C7 litigation or the Samsung and Apple dispute which was allocated two Federal Court judges to determine).
- 4.28 Michael Legg has identified a range of factors which contribute towards the rise of complex litigation, including the opportunities the adversarial system itself presents for strategic litigation aimed at winning procedural advantages over an opponent rather than dealing with the real issues, time-based billing by lawyers, the increasing legal and factual complexity of disputes, the increasing use of expert evidence, and the impact of technology on discovery, among others.⁵⁶
- 4.29 There is also no evidence that third party funders in Australia have promoted unmeritorious class actions.⁵⁷ In twelve years of operation, IMF has never funded a case which has been struck out as disclosing no reasonable cause of action or which has been the subject of a summary judgment order. Put simply, because an adverse cost order in a class action could easily be in excess of ten million dollars, no funder in its right mind would agree to fund an unmeritorious claim. It is a matter of ongoing wonderment to the management of IMF that commentators continue to make this accusation despite the overwhelming evidence to the contrary.

Does Litigation Funding Increase the Rate of Settlement of Cases?

- 4.30 In IMF’s submission, litigation funding increases the likelihood that the claims the subject of the funding will settle. Litigation funders are sophisticated, rational, repeat players in the civil justice system. They are more likely than an unfunded claimant to be able to accurately assess the time, costs and risk consequences of having a claim go to judgment and potentially on appeal. They are therefore in a position to properly evaluate a settlement proposal. Their knowledge and experience ought to make settlement more likely, certainly in IMF’s case, 95 out of the 149 cases funded and resolved by IMF have settled, or 64%. Only 19 cases have gone to judgment (13%).
- 4.31 Furthermore it is logical that funded cases have a high rate of settlement given that funders only seek to fund meritorious cases and that funding removes the incentive for defendants to prolong cases in the hope the claimant will run out of money. IMF has actively embraced the Federal Court protocols for pre-proceedings settlement discussions and has seen evidence that these protocols are being adopted by the legal profession more generally.
- 4.32 It has been said that funders unduly delay or even prevent the settlement of funded litigation. Professor Morabito found that all the funded class actions he studied had settled – a settlement rate which was ‘far higher’ than that of non-funded class actions.⁵⁸ He also found ‘no major differences’ between the time taken to settle funded and non-funded class actions or that funded class actions were less vigorously pursued.⁵⁹ IMF took slightly longer to resolve its funded matters by settlement than by judgment (this might reflect relative differences in the complexity of the cases), but the difference was not material.
- 4.33 It is important to note that the claimants’ interests are protected in relation to settlements, through the use of independent counsel to advise on whether proposed settlements are fair and reasonable and, in the case of class actions, court approval of settlements.

⁵⁶ M Legg, note 21, 15 – 20.

⁵⁷ Grave et al, note 30, 802.

⁵⁸ Morabito, above note 19, 41.

⁵⁹ Ibid, 42.

What are the Risks Posed by Litigation Funding?

4.34 Litigation funding is seen, by its opponents, as potentially giving rise to the following risks:

- Vulnerable litigants may be subject to exploitation by litigation funders.
- Conflicts of interest between funders, the claimants and the lawyers may not be managed or resolved in the best interests of the claimants.
- There may be a lack of independence between funders and lawyers which undermines the lawyers' performance of their professional and ethical duties owed to the claimants.
- Funders may lack sufficient capital to meet their financial obligations to funded claimants and to defendants, in the event the funder is unable to pay an adverse costs order.
- Funders may facilitate the bringing of unmeritorious litigation or "strike suits" (weak claims brought with the aim of forcing defendants to settle rather than face the risks and costs of fighting the claim through the courts) or may generally increase the costs of doing business in Australia and impose unreasonable costs on the court system by promoting greater levels of litigation.

(Although, no evidence whatsoever has been produced as to the likelihood of the occurrence of any of these suggested risks).

4.35 Some of these perceived risks (e.g. that litigation funding promotes unmeritorious litigation) have been dealt with above. Others are addressed through existing regulation (e.g. the Regulations referred to below require funding agreements to comply with Division 2 of Part 2 of the *Australian Securities and Investments Commission Act 2001 (C'th)* which deal with unfair contracts, unconscionable conduct and consumer protection) or can be addressed through the proposed regulation discussed next.

How Should Litigation Funding be Regulated?

Current Regulation

4.36 Until quite recently, litigation funders in Australia were unregulated, unless they chose to obtain an Australian Financial Services Licence ("AFSL").⁶⁰ In May 2010, the Minister announced that the government had decided to deliberately adopt a "light-touch" regulatory regime to encourage the development of litigation funding (particularly, funded class actions) as a means of improving access to justice. Regulation was to be limited to ensuring that funders had adequate arrangements in place to manage conflicts of interest. The Minister specifically noted:

"Importantly, I should add that there is little evidence of any consumer suffering losses, or encountering other problems, in the conduct of class actions. This has especially been the view of consumer groups in this field. For example, during the recent consultation process it became clear that there is no record of consumers complaining in significant numbers about class actions and the way they are conducted in Australia."

⁶⁰ IMF held an AFSL between 2005 and 2012. As a result of changes in the law (particularly the High Court's decision in *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed)* [2012] HCA 45) IMF applied to ASIC to have its AFSL cancelled. ASIC granted IMF's request on 18 April 2013.

*It is clear that any Government intervention would need to be proportionate to the problem. Otherwise, we would risk placing an excessive burden on the [litigation funding] industry, and potentially impose barriers to entry; all to the detriment of Australian consumers.*⁶¹

4.37 In July 2013, the Corporations Amendment Regulation 2012 (No. 6) came into force (“the Regulations”). The Regulations apply to both single-party and multi-party litigation funding arrangements. They exempt a litigation funder from the need to hold an AFSL and require the funder to maintain, for the duration of any litigation it funds, “adequate practices for managing any conflict of interest that may arise” in relation to the funded litigation.⁶² Failure to comply with the Regulations is a criminal offence and non-complying litigation funding agreements may be unenforceable.

4.38 The Australian Securities and Investments Commission (“ASIC”) has published a comprehensive Regulatory Guide on the Regulations, which promotes the development of an extensive compliance regime for funders. In ASIC’s view, a conflict may arise in funded litigation as a result of the *divergence of interests* between the funder, lawyers and claimants. This can arise because:

“The nature of arrangements between parties involved in a litigation scheme or a proof of debt scheme has the potential to lead to a divergence between the interests of the members and the interests of the funder and lawyers because:

- (a) the funder has an interest in minimising the legal and administrative costs associated with the scheme and maximising their return;*
- (b) lawyers have an interest in receiving fees and costs associated with the provision of legal services; and*
- (c) the members have an interest in minimising the legal and administrative costs associated with the scheme, minimising the remuneration paid to the funder and maximising the amounts recovered from the defendant or insolvent company.*

*The divergence of interests may result in conflicts between the interests of the funder, lawyers and members. These conflicts of interest can be actual or potential, and present or future.*⁶³

4.39 ASIC’s compliance scheme requires funders to develop their own conflicts management policies, as they are “best placed to know [their] own interests and where conflicts may arise” in the course of their business.⁶⁴ However, ASIC provides detailed suggestions on how funders might meet ASIC’s expectations in complying with the Regulations. Their key elements of ASIC’s approach are:

- each funder is to review its business and identify any actual or potential conflicts;

⁶¹ The Hon Chris Bowen MP, note 30, 7.

⁶² The Regulations also exempt litigation funding schemes from the definition of “managed investment scheme” in the Corporations Act 2001 (C’th) and declare that they are not credit facilities (thereby exempting funders from the need to observe the National Credit Code). The regulations effective reversed the decision of the High Court in *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed)* [2012] HCA 45, which held the litigation funding arrangement in that case to be a “credit facility”, and the Full Federal Court’s decision in *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2009] FCAFC 147, which held a funded class action to be an unregistered (and therefore unlawful) managed investment scheme.

⁶³ Australian Securities and Investments Commission; *Litigation Schemes and Proof of Debt Schemes: Managing Conflicts of Interest*, Regulatory Guide 248 (2013) (“RG”), 248.11, 248.12.

⁶⁴ RG 248.23, 248.25.

- each funder is to formulate and adopt a Conflicts Management Policy;
- a member of the funder's senior management is to have oversight of the Policy;
- there is to be regular review and updating of the Policy;
- conflicts are to be disclosed to clients;
- processes for recruiting claimants are to be subject to the conflicts regime;
- funders are to conduct regular reviews and, if necessary, amend funding agreement terms to ensure compliance with the Regulations;
- the primacy of the lawyers' obligations to the claimants is not to be impeded;
- measures are to be adopted to ensure the independence of the funder, lawyers and claimants or that any pre-existing relationships are disclosed;
- counsel is to conduct an independent review of all settlements;
- fair and transparent dispute resolution procedures are to be made available to clients; and
- record-keeping by funders is mandatory.

4.40 IMF will provide the Commission with a copy of its Conflicts Management Policy on a confidential basis.

Proposals for Further Proportionate and Targeted Regulation of Litigation Funding

4.41 In IMF's submission the Regulations do not, on their own, provide sufficient protection to the users of litigation funding. Further proportionate regulation of the industry is called for. The reasons for this are clear. Litigation funders provide financial support to cases claiming billions of dollars. They make financial promises which extend over many years and which, if broken, will cause much heartache and financial distress to their clients. It is important to the clients, defendants and the courts that funders have both longevity and ongoing financial capacity. Funders play, for the plaintiff, a similar role to that played by insurers for the defendant. Insurers are required to be licensed and the same must surely apply to litigation funders.

4.42 Regulation of funders needs to address the following areas:

- mandatory licensing of funders under the AFSL regime;
- appropriate capital adequacy requirements;
- ensuring the independence of funders from the lawyers receiving funding and vice versa;
- conflicts of interest disclosure and management;
- disclosure of the involvement of funders in civil proceedings;
- funder's duties to the Court; and

- fair and transparent dispute resolution processes as between the funder and its funded claimants.
- 4.43 Government could, by further regulation, require litigation funders to hold an AFSL. The AFSL regime prohibits inappropriate conduct, requires financial reporting and adequacy and enables the regulator (ASIC) to prevent the entry of inappropriate operators to the industry or to remove operators when they breach the rules.
- 4.44 There is only one argument raised against the licensing of litigation funders – that such licensing would reduce competition – but that is no argument at all. IMF held such a license between 2005 and 2012 and only relinquished it when the High Court declared litigation funding agreements were not financial products or services. The cost of obtaining and holding the license is minimal and, so long as the funder is prepared to follow the law, the impact on day-to-day operations is also minimal. The advantages, in terms of enhanced consumer protection, in subjecting litigation funders to the AFSL regime are set out at the end of this section.
- 4.45 In addition to requiring funders to hold an AFSL, the regulatory regime needs to include some features derived from the particular characteristics of litigation funding. These additional measures should include:
- a requirement that funders be liable to meet any adverse costs orders courts may make against them or their clients in litigation they fund. This is an important incentive against funders seeking to commence unmeritorious litigation or “strike suits”;
 - a requirement that funders and the lawyers they fund operate strictly on an arms’ length basis.⁶⁵ That is, the lawyers should not have a material ownership interest in the funder and vice versa (at least while the present State-based prohibitions on lawyers charging contingency fees remain in place). This measure would reduce potential conflicts of interest⁶⁶ and avoid any risk that the lawyers’ professional obligations owed to the claimants be compromised by their involvement in funding the litigation;
 - a corresponding requirement that all funded claimants have a direct (contractual) relationship with the lawyers in the funded litigation; and
 - the torts of maintenance and champerty should finally be abolished in Queensland, Western Australia and the Northern Territory, to bring those jurisdictions into line with the ACT, New South Wales, South Australia and Victoria.

The Advantages of Subjecting Funders to the AFSL Regime

- 4.46 Section 911A of the *Corporations Act 2001 (C’th)* (“the Act”) requires that any person who carries on a financial services business in Australia must hold an Australian financial services license covering the provision of the financial services. Under s766A(1)(b)⁶⁷ a person provides a financial service if they deal in a financial product.

⁶⁵ Traditionally lawyers and funders have operated on an arms’ length basis to each other. The development of litigation funding in Australia was partly due to the strict and long-standing prohibition on lawyers charging contingency fees (i.e. fees calculated as a percentage of the client’s recovery). That restriction does not apply to funders which are not law firms. Lawyers Maurice Blackburn have applied to the Federal Court for approval for a litigation funder associated with the firm, to fund a class action being conducted by Maurice Blackburn. The regulations proposed by IMF in this submission would, if enacted, prevent a law firm from setting up a funder to fund litigation in which the law firm is retained.

⁶⁶ As an American commentator has observed: “One could argue that the difficulty of an attorney’s maintaining professional objectivity is greater where his own money is at stake than when a third party is funding the litigation. Viewed in this light, third-party funding actually offers a safeguard against impermissible attorney bias because it puts financial concerns at one step removed.” J Lyon, “Revolution in Progress: Third-Party Funding of American Litigation” (2010) 58 *UCLA Law Rev* 571, 607 (citations omitted).

⁶⁷ All references to statutory provisions in [4.46] to [4.67] of this submission are to sections in the Act.

- 4.47 The effect of the High Court's decision in *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed)*⁶⁸ is that single party litigation funding arrangements are not financial products. The Regulations provide that an interest in a litigation funding scheme or litigation funding agreement is a financial product but, as discussed above, effectively exempt funders who comply with the conflicts management rules.
- 4.48 Section 912A sets out the general obligations which are imposed upon the holder of an AFSL. All of the obligations are relevant to litigation funding in that they tend to protect the client, the public and the courts from inappropriate conduct on the part of litigation funders. From this point on the submission will refer to the funder as though it is a licensee.
- 4.49 The first obligation set out in section 912A is that the financial services covered by the license (i.e. the provision of litigation funding agreements ("LFAs")) are to be provided efficiently, honestly and fairly. Under this provision an incompetent funder, a dishonest funder and a funder who enters into unfair contracts will be in breach of the Act and liable to lose its license.
- 4.50 The section then obliges the litigation funder to have in place adequate arrangements for the management of conflicts of interest. This would supplement or supersede the existing comprehensive regime imposed by the Regulations. This, again, is a central requirement of litigation funding because such conflicts can arise both as between the position of the funder and the position of the client as well as between the funder, the client and the retained lawyers.
- 4.51 The section then obliges the funder and its representatives to comply with the conditions on the licence and with all financial services laws, whether they be Federal or State. The funder is required to take reasonable steps to ensure that its representatives comply with the financial services laws.
- 4.52 Importantly, the funder is obliged to have adequate financial, technological and human resources so as to enable it to provide its litigation funding services. This is a central requirement for effective litigation funding, i.e. the certitude that the funder will be on hand to pay out any adverse cost orders which may be made years after the relevant LFA is entered into.
- 4.53 The section then obliges the funder to ensure that both itself and its representatives are adequately trained and competent to provide the services set out in the LFA. The section also requires that, in relation to "retail clients" (as that term is defined in the Act), the funder has a dispute resolution system which complies with section 912A(2). Finally, and most importantly, the section requires that the funder has adequate risk management systems in place. It is difficult to envision a better set of requirements suitable for the regulation of litigation funding.
- 4.54 Section 1019B requires a funder to provide a 14 day cooling off period to allow the retail clients to reconsider the transaction.

Compensation Arrangements

- 4.55 Section 912B requires that if litigation funders provide their service to retail clients, they must have in place arrangements for compensating those retail clients for loss or damage suffered because of any breach of the obligations referred to above.
- 4.56 Section 912B (2) provides that the arrangements must comply with regulations made for that purpose.

⁶⁸ [2012] HCA 45.

- 4.57 Regulation 7.6.02AAA provides that a funder must hold professional indemnity insurance that is adequate having regard to:
- (a) the funder's membership of a dispute resolution system; and
 - (b) the volume of business, the number and kind of clients, the kinds of business and the number of representatives employed by the funder.
- 4.58 Under these arrangements a licensed litigation funder would be required to hold sufficient professional indemnity insurance to ensure that any damage it may cause to clients is covered by that insurance. Not to hold such insurance would be a breach to the Act and would lead to loss of the license.

Disclosure

- 4.59 Section 941A of the Act requires a funder to give a retail client a Financial Services Guide. The guide must contain all of the information referred to in section 942B (2) (being information regarding the funder and the business conducted by the funder). It is an offence for the funder not to provide a Financial Services Guide as required by the Act.
- 4.60 Section 1012B requires the funder to provide a Product Disclosure Statement either at or before the point of issue of the LFA. The Product Disclosure Statement must contain (under section 1013D) the following information about the funder and the LFA:
- (a) the identity of the issuer of the LFA;
 - (b) information about the benefits produced by the LFA;
 - (c) information about any significant risks associated with the LFA;
 - (d) information regarding the costs and any amounts payable by the client;
 - (e) information about any commission or other similar payments to be made to the funder;
 - (f) information about significant characteristics or features of the LFA and the rights, terms, conditions and obligations arising from the LFA;
 - (g) information about the dispute resolution system covering complaints by clients about the LFA or the funder; and
 - (h) information about any cooling off regime;
- 4.61 As can be seen, this list of requirements for a Product Disclosure Statement relating to a LFA is entirely appropriate for the information and protection of funded clients.
- 4.62 A funder which has an obligation to provide a Product Disclosure Statement commits an offence by not doing so (refer to section 1021C) and, in addition, the client may take action under section 1022B for any damages or loss caused by that failure. The Court has extensive powers under section 1022C in dealing with any funder who fails to provide the Product Disclosure Statement, including a power to declare the LFA to be void and to order that any monies paid under the LFA be returned to the client.

Oversight by ASIC

- 4.63 ASIC currently employs numerous trained staff capable of overseeing licensed litigation funders and enforcing the provisions of the Act and the license held by the funder. The cost and time involved in replicating this enforcement staff would be so high as to, by itself, be a compelling reason against regulation other than by ASIC under the terms of the Act. In any event ASIC is currently regulating funders under the Regulations.
- 4.64 Section 912E requires all funders to give such assistance to ASIC as ASIC reasonably requests from time to time during its surveillance activity. Funders are specifically required to give ASIC access to their books and records and any other information requested by ASIC. Under section 912D the funder must advise ASIC of any breach or likely breach of the Act or any other financial services legislation. Under section 912C ASIC may give notice to a funder to provide a statement to ASIC regarding the financial services provided to clients and/or the conduct of the business carried on by the funder. Under this section ASIC may also require the funder to provide an audit report to ASIC.

Enforcement

- 4.65 Both ASIC and the courts are given strong enforcement powers over licensed litigation funders by various provisions of the Act.
- 4.66 Section 915C empowers ASIC to suspend or cancel a funder's license if:
- (a) the funder has not complied with the obligations referred to above;
 - (b) ASIC has reason to believe that the funder will not so comply; or
 - (c) ASIC is no longer satisfied that the representatives of the funder remain of good fame and character.
- 4.67 Under section 920A ASIC can ban persons from being involved in the provision of litigation funding and pursuant to section 921A the Court may cancel a license held by a litigation funder or itself make banning orders against persons involved in litigation funding that are to operate permanently.

How has the use of contingent billing improved access to civil justice in Australia, and could it be improved? What regulatory constraints should be used in relation to contingent billing and why?

Contingency Fees

- 4.68 Contingency fee charging by lawyers (i.e. the lawyer's fees being calculated as a percentage of the client's recoveries) is currently prohibited in all States.⁶⁹
- 4.69 The reason they are prohibited in Australia, even though they are common in the United States, is that "they create a more serious conflict of interest than conditional [i.e. no-win, no-fee] costs agreements."⁷⁰ Professor Morabito has explained the conflicts which can arise in these terms:

⁶⁹ Legal Profession Act 2004 (NSW), s234; Legal Profession Act 2004 (Vic), s3.4.39; Legal Profession Act 2008 (WA), s285; Legal Profession Act (NT), s320; Legal Profession Act 2007 (Tas), s309; Legal Profession act 2006 (ACT), s285; Legal Practitioners Act 1981 (SA), s42(6); Legal Profession Act (Qld), s324.

⁷⁰ C Parker and A Evans, *Inside Lawyers' Ethics* (Cambridge University Press, 2007), 192.

“The most persuasive criticism of contingency fee agreements is the potential for conflict of interest which they create in relation to such matters as settlement of the client’s claim. The contingent nature of the lawyer’s remuneration creates a strong financial incentive for the lawyer to ‘accept a small settlement in order to ensure some fees, rather than risk losing at trial and recovering nothing’. This incentive to settle for sub-optimal amounts would appear to exist in relation to both uplift fees and percentage fees.

An obvious response to this argument is to say that a client would not accept settlement terms which are contrary to his/her own best interests. Unfortunately, the fear of losing, ‘the client information disadvantage and the inability to evaluate’ the validity of the settlement package recommended by the lawyer may result in the client’s authorisation of inferior recoveries.

The losses incurred as a result of the conflicts of interest which exist between principals and agents are described by economic scholars as ‘agency costs’. Given the unreliability of ‘monitoring’ by the client as a means of reducing agency costs, reliance must be placed on other safeguards such as the legal regulatory system and the importance placed by lawyers on maintaining a good reputation. It is difficult to see, however, how the prospect of disciplinary action or loss of reputation can provide an effective means of eliminating agency costs in the context of settlements given that the lawyers in question are able to point to the ‘objective’ fact that they have achieved a victory on behalf of their clients. Furthermore, as Macey and Miller have pointed out, the devices to reduce agency costs ‘are themselves costly’.”⁷¹

4.70 Third party litigation funding can reduce the agency problem by ensuring that the lawyer is remunerated regardless of the outcome to the litigation and by introducing a sophisticated and skilled repeat litigant whose interests are aligned with the claimant’s but who does not suffer the same level of information disadvantage as the claimant.

4.71 As Shueh Hann Lim has argued:

“...although the use of a litigation funder increases the number of agents with self-interest in the case that is distinct from the client’s, the resulting effect is that the client’s interests are more protected. As Coffee has suggested, this structure is inherently one in which “agents are watching agents.”...Furthermore, even though litigation funders have an incentive to settle early and lock in the gains from their initial investment in the suit, the lawyers, who in Australia are paid on a non-contingent hourly basis, would have little, if any, incentive to settle early and may even wish to stretch out the litigation. Hence the law firms’ self-interest would counterbalance those of the litigation funder.”⁷²

4.72 The third party litigation funding model also arguably places less strain on lawyers’ performance of their fiduciary duties to the claimants. IMF’s John Walker has argued:

“The policy considerations for requiring the traditional fiduciary duties of lawyers to their clients to be unfettered by any third-party funding are compelling.

Protection of this fiduciary relationship from commercial influences is a primary consumer protection mechanism.

⁷¹ V Morabito, “Federal Class Actions, Contingency Fees, and the Rules Governing Litigation Costs” (1995) 21 *Monash U L Rev* 231, 246 – 247 (citations omitted).

⁷² S H Lim, note 1, 149 (citations omitted).

Any fettering of these duties will diminish the structural protections enjoyed by clients in equity that have stood the test of time; protections that are at the front line when clients confront the need for litigation funding.

At present, clients can expect, and regulators of the legal profession can require, lawyers not to put their clients' interest in potential conflict with their personal interests and, in particular, not to profit in such circumstances.

These duties are the hallmark of the legal profession and the foundation of the professions' right to self-regulate and its reason for existence. They are also why the community holds lawyers in high esteem.

Requiring that funders be licensed and remain independent from lawyers throughout proceedings protects the sanctity of the legal profession and enables access to justice. Funders should be prohibited from holding any interest (financial or through common office holders) in the law firm conducting the claim being funded. It is in the interest of all concerned for there to be a clear demarcation between funding and legal services.”⁷³

- 4.73 However, IMF accepts that allowing Australian lawyers to charge contingency fees would be likely to improve access to justice in this country and would also increase competition for litigation funding. Contingency fee charging in litigation has recently been introduced in the UK as a result of the Jackson reforms although, anecdotally, its take up appears to be slow. Any reform in this area in Australia will, nevertheless, require amending State legislation and if lawyers are to be permitted to charge contingent fees, the legislation should make it clear that they should also be potentially liable to pay adverse costs orders in litigation they fund.

5. The Role of Funded Class Actions in Access to Justice

How Effective are Class Action Procedures in Providing Access to Justice?

- 5.1 IMF uses the term “class action” broadly to refer to representative proceedings under Part IVA of the *Federal Court of Australia Act 1976* (C'th) (Part IVA), proceedings under provisions equivalent to Part IVA found in the Rules of the Supreme Courts of Victoria and New South Wales and to multi-plaintiff or group claims.⁷⁴
- 5.2 IMF's submission in relation to the effectiveness of class action procedures in providing access to justice is informed by its experience in funding securities class actions of significant scale and consumer class actions such as the “Bank Fees” case. However, and while all class actions need some form of financial support, not all class actions proceed with the support of a commercial litigation funder, for example class actions pursued on the basis of a no win/no fee arrangement with the lawyers acting for the representative or class actions where the group members provide full or part funding to the lawyers.⁷⁵
- 5.3 To date, class actions (and particularly class actions funded by commercial litigation funders) have been highly effective in achieving access to justice for the hundreds of thousands of group members in those actions. Once thought novel and unusual, class actions are now an established feature of the commercial litigation landscape and have a demonstrable track

⁷³ J Walker, “Litigation Funding Rules Face Scrutiny”, *The Australian* (2 August 2013), 29 – 30.

⁷⁴ Multi-Plaintiff proceedings are proceedings commenced by two or more persons whose claims raise common issues of fact and law or where the relief claimed is in respect of, or arises out of, the same transaction or series of transactions – see Part 9 of the Federal Court Rules 2011, Order 6, Rule 19 of the Uniform Civil Procedure Rules 2005(NSW) and Rule 9.02 of the Supreme Court (General Civil Procedure) Rules 2005 (Vic).

⁷⁵ For example, *Richards v Macquarie Bank Limited* (No 4) 2013 FCA 438 (a class action in which certain group members contributed to the costs of the action); *Kelly v Wilmott Forests Ltd (in liquidation)* [2012] FCA 1446 (an example of a class action substantially unfunded with a conditional costs agreement between the Applicant and the Applicant's lawyers).

record of recovering significant sums for the victims of corporate and other wrongdoing.

- 5.4 Class actions provide a means by which a group of claims with common features can be aggregated efficiently (as to process, time and cost) and enables claims to be pursued which may not be viable on an individual basis. Pursuing claims through a class action rather than on an individual basis has the collateral effect of minimising administrative burdens on the civil justice system by avoiding a multiplicity of claims and case management and procedural difficulties relating to multiple sets of proceedings.
- 5.5 By gathering numerous claims together in the one proceeding, critical mass is achieved and the power of the claimants both in the litigation process and in relation to settlement of the claims is significantly enhanced. The power imbalance between small claimants of limited means and large highly resourced defendants can be ameliorated to the benefit of the claimants. The role of class actions in facilitating access to justice and the role that litigation funding plays in class actions have been significant themes in the consideration of the regulatory framework for litigation funding and the “light touch” regulatory approach which has been adopted to date (as discussed above).⁷⁶
- 5.6 While media interest in class actions remains high, in real terms there has not been an explosion in the number of class actions.⁷⁷ An analysis by the law firm Allens Linklaters (who generally act for class action defendants) debunks the myth of an “explosion” in shareholder class actions. In 2006 two actions were filed while by 2008 this had risen to six. In 2012 only one action was filed and the trend for 2013 is likely to be similar.⁷⁸ Class actions in Australia make up a tiny proportion of proceedings commenced each year and tend to self-regulate due to a number of factors including:
- 5.6.1 the representative party’s responsibility for own costs and adverse costs. Under Part IVA only the representative is exposed to an order for costs. Only in exceptional circumstances can group members be exposed to an order for costs. However, as the representative bears all the responsibility for adverse costs, there are strong disincentives to becoming a representative party in the absence of external financial support;
 - 5.6.2 there are real financial consequences in the event that a claim fails. This distinguishes the Australian class action regime from the American class action regime. In the USA there is no liability for adverse costs and claimants’ lawyers are permitted and well used to acting on a contingency fee basis;
 - 5.6.3 the Court’s significant role in overseeing class actions including “declassing” proceedings, active case management and settlement approval;
 - 5.6.4 in class actions funded by a commercial litigation funder, a motivation to protect the funder’s investment and maximise the prospect of a timely return on that investment by investing in commercially viable claims with high prospects of success; and
 - 5.6.5 the reluctance of institutions to join funded class actions unless they perceive the prospects of success to be strong.

⁷⁶The Hon Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, “Government Acts to Ensure Access to Justice for Class Action Member” (speech delivered at IMF (Australia) Ltd Shareholder Class Action Conference, Quay Grand Suites, Sydney, 4 May 2010).

⁷⁷Morabito V, An empirical study of Australia’s class action regimes – First Report; Class Action Facts and Figures (Dept of Business Law and Taxation, Monash University), December 2009; Morabito V, An empirical study of Australia’s class action regimes – Second Report; Litigation Funders, Competing Class Action, Opt Out Rates, Victorian Class Actions and Class Representatives, (Dept of Business Law and Taxation, Monash University), September 2010.

⁷⁸Allens Linklaters, Shareholder Class Actions in Australia, August 2013 (available at website http://www.allens.com.au/pubs/ldr/papldraug13_02.htm).

- 5.7 Class actions (particularly, securities class actions) are effective at achieving access to justice as the actions which proceed are meritorious, carefully selected and in most cases result in a substantial settlement for the benefit of group members.⁷⁹
- 5.8 The US Chamber Institute for Legal Reform (“US Institute”) has asserted that commercial litigation funding and, by extension, funded class actions can be expected to prompt an increase in questionable and meritless claims due to the fact that funders would accept weaker cases and spread the risk on these cases among the funder’s portfolio of claims. This is not the trend which has emerged in Australia. The Institute is informed by the features of the US market and fails to account for the particular self-regulating aspects of the Australian class action system outlined above.
- 5.9 In a recent publication commissioned by the US Institute,⁸⁰ it is suggested that trends in investor class actions (relating to case selection, class closure and the use of “closed” rather than “open” classes) demonstrate that funded class actions in reality provide only limited additional access to justice and so the regulatory light touch approach is misconceived. However, the analysis is focussed too narrowly and overlooks a range of class actions which assist small claimants, such as the Bank Fees class action (claim for recovery of exception fees on behalf of over 170,000 claimants), the class action against Lehman Brothers Australia Limited (in liquidation) (on behalf of local councils, charities and churches) and the claims by holders of Notes and Debentures issued by Fincorp Investments Ltd (principally small retail investors).
- 5.10 Through group proceedings and class actions funded by IMF, funded clients (principally wholesale and retail investors in listed entities) have recovered over \$982m in compensation with over \$648m of that amount being accounted to the funded clients by IMF. While it may be difficult to prove empirically, it is almost certain that a large proportion of these funds would not have been recovered but for the access to justice afforded by class actions supported by IMF. Total returns on class actions funded by other commercial funders are less easy to identify.
- 5.11 It should be noted that there are certain structural deficiencies in the present Australian class action regime,⁸¹ principally in relation to the availability of funding for class actions and the disincentives arising from liability for adverse costs to which a representative party is exposed. Litigation funders play an important role in overcoming these deficiencies as a funder will bear the costs and adverse costs risk associated with significant class actions.
- 5.12 In addition to the benefits of class actions to group members, both ASIC and the Australian Consumer and Competition Commission (“ACCC”) have recognised the role played by investor class actions in holding boards of directors of listed companies accountable, assisting in market regulation and enhancing access to the law.⁸²
- 5.13 While class actions are an important feature of the civil justice system and provide access to justice to many, they are presently an incomplete solution to the challenge of effective access to justice. There remain limitations on the fuller development of funded class actions in Australia. These limitations include:
- 5.13.1 the difficulty with a funder’s ability to support “open classes” and ensure that the benefits and burdens of such a class action are fairly shared among the eligible group members. This difficulty has given rise to the “closed class” preferred by litigation

⁷⁹ J. Walker, S. Khouri and W. Attrill, note 2.

⁸⁰ M. Saville, P. Stevenson and C. Rodgers, “Third Party Litigation Financing in Australia, Class Actions, Conflicts and Controversy,” US Chamber Institute for Legal Reform, October 2013.

⁸¹ See Grave, Adams and Betts, note 30, 741 – 744.

⁸² A Boxell, “Regulators praise private court actions”, *The Weekend Australian Financial Review*, 5 – 9 April 2012, 59.

funders in which the proceedings operate on an “opt in” basis (i.e. group members must sign a funding agreement with the funder or a retainer with the lawyers to become a group member) rather than the “opt out” model (group members simply need to conform to a group definition and if they do not wish to be a group member, they must elect to opt out of the proceedings) adopted under Part IVA and its equivalents;

- 5.13.2 linked to the difficulty with funding an “open class” is the lack of a developed common fund approach. Under a common fund order the funder's commission is paid out of any settlement or judgment proceeds that are received by all class members (whether they have signed a funding agreement or not), subject each class member's right to opt out of the class action; and
- 5.13.3 commercial funders and class action lawyers cannot use the share registers of listed entities to communicate directly with potential claimants to inform them of their rights.⁸³ Commercial funders rely on imperfect indirect methods of communication such as mail outs, advertising and media interest.
- 5.14 A further important control within the class action regime in Australia is that all settlements of filed class actions require court approval.⁸⁴ Recent court decisions on the approval of settlements proposed in relation to the Storm Financial claims, the claims relating to the drug “Vioxx”⁸⁵ and the decision of the Federal Court in relation to the costs in the GPT class action, all show that the court will not simply “rubber stamp” settlements proposed by the lawyers acting in the class action and that settlements must operate fairly and reasonably in all respects as between group members. This is an important feature of the Australian class action framework and ensures that class action settlements are effective in delivering real benefits to group members.

<p>How Effective are General Disclosure Requirements (such as Cost Estimates) in the Context of Class Actions?</p>
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- 5.15 IMF has invested in excess of \$40 million per annum in 2012 and 2013 in the funding of litigation. This investment is, for the most part, in legal costs (solicitors and barristers) and other expenses associated with the conduct of litigation (expert's fees, Court fees, transcript fees).
- 5.16 Given the size of IMF's investment, IMF exercises high levels of vigilance in relation to legal budgets and has the sophistication to ensure that costs are reasonably and necessarily incurred. This discipline may not be found to the same extent in cases which are not externally funded.
- 5.17 The accurate budgeting and estimating of legal costs in large scale litigation is an extremely challenging task. Estimates provided by the lawyers at the commencement of a proceeding may bear little resemblance to the costs actually incurred at the end of a proceeding. Defendant's tactics, particularly in the interlocutory stages of litigation, can cause serious and unpredicted increases in claimant's legal costs.

⁸³ In *IMF (Australia) Limited v Sons of Gwalia (administrators appointed)* [2005] FCAFC 75 the Full Federal Court held that litigation funders cannot advise shareholders of class actions by using the share register. Special leave to the High Court was refused. Gummow J commented that s177 of the Corporations Act lacks clarity and amendment to the section should be considered.

⁸⁴ See section 33V of Federal Court of Australia Act 1976 (C'th).

⁸⁵ *Peterson v Merck Sharp Dohme (Aust) Pty Ltd (no. 6)* [2013] FCA 447 (17 May 2013); *Australian Securities and Investments Commission v Richards* [2013] FCAFC 89 (12 August 2013); *Modtech Engineering Pty Limited v GPT Management Holdings Ltd* [2013] FCA 626 (21 June 2013) (*Modtech*).

- 5.18 Presently, lawyers acting for an applicant in a class action are required to comply with their professional obligations as to costs disclosures but there is little additional oversight (apart from external funders) and few consequences in the event that budgets are not managed or estimates are significantly exceeded.
- 5.19 One important external control on costs incurred in connection with a class action is the court approval required as part of any settlement. As part of the hearing to approve resolution of a class action, the court receives evidence of costs disclosures and estimates provided by the applicant's lawyers and the costs actually incurred by the applicant and considers whether to approve the payment of those costs from the settlement fund.
- 5.20 In a recent case of *Modtech*, Justice Gordon of the Federal Court explained the task the Court must discharge when asked to approve the legal fees to be paid from the settlement fund. In most cases, the group members do not have access to costs information and so cannot act as a "contradictor" by presenting arguments which might challenge the approval of the fees being sought. This situation warrants the court's "surveillance" of the lawyers' costs in the context of a settlement approval.
- 5.21 Justice Gordon has suggested, extra-judicially, that the lawyers' fee agreements (and any funding agreements) in class actions might be approved at the outset of the proceedings and before the agreements become binding on group members.⁸⁶ This suggestion, of increased Court intervention to monitor and manage legal fees, echoes recommendations made by Lord Justice Jackson in his Review of Civil Litigation Costs and recent amendments to civil procedure rules relating to approval of lawyers' budgets by the court in significant commercial litigation matters in the United Kingdom. It will be interesting to see the impact of these English developments.
- 5.22 In Australia, costs disclosure requirements appear broadly effective. In the class action context, the challenge is in implementation and in engendering in lawyers an awareness regarding costs management and efficiency to ensure that legal costs incurred in class actions remain fair, reasonable and proportionate in all the circumstances.
- 5.23 In class actions commenced in the Federal Court disclosure of the funding agreement (redacted if necessary) is required at the initial case management conference.⁸⁷ IMF is in favour of early disclosure of the financial backing of both sides. A requirement on defendants to disclose the terms of any insurance policy which responds to the claim will facilitate early and realistic resolution of claims.

6. Civil Justice System Reforms

How can the Commission add value in undertaking this enquiry?

- 6.1 Prior enquiries and reports into access to justice have for the most part adopted a legal perspective on this important issue. The Commission can add value to the present inquiry by analysing the issue through an economic, rather than a legal, lens. An economic focus will allow the costs of accessing justice and the costs to the community arising from limitations on access to justice to be analysed and measured and this analysis will inform ways that access to justice can be improved efficiently and effectively.
- 6.2 The Commission can use an economic framework to identify desirable changes to the civil justice system and to measure the economic benefits which might flow from such changes.

⁸⁶ Comments at Maurice Blackburn Class Action Symposium, Melbourne, 24 October 2013; *Modtech* at 27.

⁸⁷ Federal Court Practice Note CM 17 at 3.6.

By measuring potential economic benefits, the case for legislative reform to increase access to justice at both a Federal and State level can be demonstrated.

Comments on the financial costs of civil dispute resolution

Financial Costs of Dispute Resolution

- 6.3 The costs of civil dispute resolution are prohibitive even for the very wealthy. John Symond's experience in recent litigation is a case in point.⁸⁸
- 6.4 There is a significant lack of empirical data relating to legal and others costs which parties incur in civil disputes resolution. This information is not gathered by the Courts or other Government agencies.⁸⁹
- 6.5 Through information provided by repeat users of the civil justice system (Commonwealth bodies such as the Australian Securities and Investments Commission (ASIC) and the Australian Competition and Consumer Commission (ACCC), State and Federal Governments and participants such as IMF), it is possible to gather some evidence of total costs spent on an annualised basis. For example, in the years ended 30 June 2012 and 30 June 2013, IMF invested in excess of \$40 million in legal costs on its funded cases and in the year ended 30 June 2013, ASIC had spent \$24.2 million in legal and forensic costs on litigation in which it was involved and the ACCC \$28.5 million.⁹⁰ However, there is a distinct lack of more granular data which would enable an analysis of costs associated with individual matters and against which the effectiveness of changes made to the civil justice system (such as increased case management or changes to limit discovery in civil cases) can be measured.
- 6.6 In IMF's experience, the financial costs of civil dispute resolution increase year on year. One cause of this increase is annual increases in charge-out rates by lawyers. In many of IMF's funded cases, the lawyers seek repeated annual increases in fees. Barristers also review their charge-out rates on an annual basis and often apply annual increases of 5-10%.
- 6.7 In 2010, generally increasing legal costs and the need to ensure that costs remained proportionate to amounts in issue caused IMF to increase the minimum value of the claims it is prepared to fund. For single party matters, IMF increased its minimum claim amount from \$2 million to \$5 million. For this reason, IMF is also unwilling to fund multi-party actions with a claim value of less than \$30 million.

Proportionality

- 6.8 Proportionality recognises that the time and effort put into a case by the various parties must be commensurate with the importance of the issues and the value of the subject matter involved.
- 6.9 Proportionality involves "recognition at the onset that the case could easily result in disproportionate costs being incurred. The nature of the claim requires the parties conducting the litigation to plan how it should be carried out so as to minimise expense".⁹¹ Citing with approval the observations of Judge Alton in another case, Lord Woolf said:

⁸⁸ See section 3 of IMF's Submission.

⁸⁹ See further Annette Marfording, "Pointers to Effective Civil Justice Reform in New South Wales – Opportunities to learn from German Civil Procedure" Chapter 24, *The Future of Dispute Resolution* (Lexis Nexis Butterworths, 2013), 260.

⁹⁰ IMF (Australia) Ltd, 2013 Annual Report at 25 see cash flows from investing activities; ASIC Annual Report 2012 – 2013 Financial Statements at 103; ACCC and AER Annual Report 2012 – 3 at 11.

⁹¹ *Home Office v Lownds* [2002] EWCA Civ 365.

“In modern litigation, with its emphasis on proportionality, it is necessary for the parties to make an assessment at the outset of the likely value of the claim and its importance and complexity and then to plan in advance the necessary work, the appropriate level of person to carry out the work, the overall time which would be necessary and appropriate to spend on the various stages in bringing the action to trial and the likely overall cost.”⁹²

- 6.10 Ensuring that the costs of dispute resolution are proportionate to the matters at stake presents continuing challenges. For lawyers, there is presently no sanction if costs cease to be proportionate and for so long as the client is prepared to continue to pay fees rendered. In other jurisdictions, proportionality forms part of the basis on which lawyers can charge. As an example, in Germany lawyer’s fees for civil litigation work are fixed by statute on a claim value basis.⁹³

Judging Expected Costs and Benefits of Litigation

- 6.11 The risks of embarking on litigation are enormous and the civil justice system does little to assist consumers in properly understanding and assessing those risks.
- 6.12 The risks are mostly financial, but are also reflective of what economists would call “information asymmetry”, where parties are not able to access the same information as a result of a power imbalance, typically between plaintiff and defendant, but also between client and lawyer.
- 6.13 Prospective plaintiffs are not assisted by the general lack of data regarding the workings of the civil justice system (such as the participation of insurance companies in the defence of proceedings and the nature of insurance contracts). The general policy of the operation of the courts is that court business is conducted in public and that their work is a matter of public record. But as Sackville J has observed, courts must “improve the quality of data available as to the workings of the justice system” because “unless the courts actively participate in the process, the danger is that less sympathetic and less knowledgeable agencies will control the debate.”⁹⁴
- 6.14 Litigation risks include:
- (a) not being able to obtain an accurate budget from the lawyer;
 - (b) not being able to negotiate with the lawyer to provide their service for a fixed fee and thereby being subject to a pricing policy where the lawyer charges by the hour;
 - (c) not being able to predict how long the process will take with any degree of certainty;
 - (d) not being able to accurately define the issues in the litigation at the outset or assess its outcome with any degree of certainty;
 - (e) not being able to predict how much the opposing side will spend on legal costs, and hence the potential exposure to costs if the case is unsuccessful;
 - (f) confronting well resourced defendants, often defending the action with the aid of an insurance company; and

⁹² Lord Woolf, Master of Rolls, Access to Justice, Final Report to the Lord Chancellor on the Civil Justice System in England and Wales, 1996.

⁹³ For example, in Germany fees are regulated by the Federal Statute on Attorney’s Fees (see Foster N and Sule S, German Legal System and Laws (3rd Ed, 2002), 112).

⁹⁴ R Sackville, “From access to justice to managing justice: the transformation of the judicial role” (2002) 12 *Journal of Judicial Administration* 5.

- (g) not knowing whether the defendant has the economic capacity to pay any judgment sum or is insured or whether any insurance policy will respond to the claim in question, or the level of cover (the “Litigation Risks”).
- 6.15 The Litigation Risks add significantly to uncertainty which many claimants consider to be the major barrier to enforcing their rights. For many users of the civil justice system, the decision to litigate will be one of the biggest decisions in their life. The decision is often made more difficult because the subject of the legal dispute has typically acted as a drain on their financial resources.
- 6.16 The Litigation Risks will probably never be completely eliminated but there must be an expectation created in the mind of parties about to embark on litigation that the civil justice system can design and deliver a process that will fulfil their legitimate expectations or:
- (a) the civil justice system will remain inaccessible; and
 - (b) the rule of law and the civil justice system as its custodian will be weakened.

Comments on the timeliness of civil dispute resolution
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- 6.17 Together with the efficient use of the limited resources available to the parties and to the Court, the avoidance of delay is a critical component of achieving justice according to the law. Time is money.
- 6.18 Legislatures around Australia have been unequivocal that the courts should adjudicate on the real issues in legal proceedings as quickly as possible, and ensure the parties are able to minimise costs. In recent years, the courts have introduced reforms to rules of practice and procedure to enshrine timeliness as part of the courts’ core mission. They must be rigorously enforced.
- 6.19 In Victoria, the *Supreme Court (General Civil Procedure) Rules 2005* provide that in exercising any power under the Rules, the Court:
- “shall endeavour to ensure that all questions in the proceeding are effectively, completely, promptly and economically determined...”⁹⁵*
- 6.20 This rule is akin to the equivalent provision in New South Wales, whereby the “Overriding Purpose” of the *Civil Procedure Act 2005* (NSW) is “to facilitate the just, quick and cheap resolution of the real issues in the proceedings”⁹⁶ (the Overriding Purpose). The courts of the other states are governed by similar principles.⁹⁷
- 6.21 The objective of the Commercial and Managed Cases List in the Supreme Court of Western Australia is to “bring cases to the point where they can be resolved by mediation or tried in the quickest, most cost effective way, consistent with the need to provide a just outcome.” The practice direction requires judges overseeing the new list to discourage interlocutory disputes with all means at the Court’s disposal, “including costs orders in appropriate cases”.⁹⁸
- 6.22 As noted, to 30 June 2013 IMF had commenced and resolved 149 funded cases with an average investment duration of 2.3 years. This is broadly consistent with statistical data from the Supreme Court of New South Wales from 2010 and 2011 and the Federal Court of

⁹⁵ Rule 1.14 (Exercise of Power) of the Supreme Court (General Civil Procedure) Rules 2005.

⁹⁶ Section 56.

⁹⁷ See, for example, Order 1 Rule 4A of the Western Australian Supreme Court Rules.

⁹⁸ Supreme Court of Western Australia, Practice Direction 4 of 2006.

Australia which shows that about 85 - 88% of cases are resolved within 18 months - 2 years of filing.⁹⁹ IMF's data (and the court data) are averages only and so cases which resolve more quickly may skew the data and cases which take longer to resolve may not be readily apparent. Further, the data does not distinguish between cases of different size and complexity.

Comments on Simplicity and usability of the civil dispute resolution system

Creating a Less Adversarial System

- 6.23 The Commission should consider the ways in which the adversarial process creates complexity, cost and delay to users of the civil justice system.
- 6.24 By demanding procedures that are geared towards the hearing, which comes at the end of the dispute resolution process and is structured as a competition between adversaries, the civil justice system often prevents the quick and cheap resolution of the real issues in proceedings. These procedures by their nature add to the complexity and opacity of civil dispute resolution.
- 6.25 Mr Geoff Davies, a former Judge of the Court of Appeal of Queensland, believes the procedures and practices which constitute the civil justice system assume two things: that proceedings, once commenced, will be resolved by trial and judgment; and that a contest between competing adversaries is the best way to resolve a dispute.¹⁰⁰
- 6.26 Both are flawed assumptions. Mr Davies says "trials would be cheaper, fairer between parties of unequal bargaining power and more objectively truthful if they were less adversarial."¹⁰¹
- 6.27 Mr Davies points to six harmful effects of the adversarial system:
- (a) it discourages the limiting of issues and disclosure of unfavourable information;
 - (b) it obscures the advantages of an agreed solution;
 - (c) it provides too few opportunities for adjudication otherwise than by a full trial;
 - (d) it tends to make advocates of the witnesses;
 - (e) it advantages the richer litigant; and
 - (f) it permits the parties to dictate the pace and shape of the litigation.¹⁰²
- 6.28 Mr Davies notes that although many matters are settled outside the trial, after proceedings are filed, the parties embark on a series of procedures designed to facilitate a trial which are not necessarily designed to accelerate settlement. Moreover, the cost structures make litigation overly labour intensive.
- 6.29 Consideration could be given to the Family Court of Australia's Less Adversarial Trial ('LAT') model, used in the Court's Children's Cases Program. As noted by Justice Stephen O'Ryan of the Family Court:

⁹⁹ Supreme Court of New South Wales, Annual Review 2010 – 11, 61; Federal Court of Australia Annual Report 2012 – 2013.

¹⁰⁰ See Geoff Davies, "Civil justice reform: Some common problems, some possible solutions", (2006) 16 *Journal of Judicial Administration* 5.

¹⁰¹ Ibid.

¹⁰² Geoff Davies, "A Blueprint for reform: Some proposals of the Litigation Reform Commission and their rationale", (1996) 5 *Journal of Judicial Administration* 201 at 205.

“The Court...decided to consider adopting a significantly less adversarial approach to determine such cases. Crucial to the implementation of such an approach would be a model where the relevant issues were identified early by the trial judge and where the trial judge could ensure that the evidence was confined to such issues within a procedure where the best interests of the children were the focus rather than the dispute of the parents”¹⁰³.

- 6.30 As noted by Cannon in his article on effective fact finding: “The adherence to the requirement that the facts be proved by oral evidence at a trial at the end of the process wastes many opportunities to decide facts that may be determinative of the case earlier and thereby avoid expensive efforts in marshalling evidence of facts that are collateral.”¹⁰⁴
- 6.31 For the 80% of cases that do not go to trial, Cannon argues that “many of these would benefit from a narrowing of the factual controversy early in the process. Even in those that go to trial a great deal of expensive effort is likely to be wasted to prove things that did not need to be proved.”¹⁰⁵

Creating a More Fuel Efficient Model

- 6.32 The implications of cost and delay in the civil justice system are serious: if recourse to the Courts is not available for the majority of Australians, then the civil justice system, which draws its authority and legitimacy from the public, risks being seen as an irrelevance; a domain of the wealthy.
- 6.33 This dynamic may result in the civil justice system falling into disrepute as “the public looks on with dismay as respect for the administration of justice erodes.”¹⁰⁶
- 6.34 There is no doubt that “case management” programs introduced in nearly all Australian courts have had a positive effect as judges have sought to exercise more control over the process.
- 6.35 Growing consumerism throughout society demands, however, that the Courts respond by further streamlining their procedures. As noted by Sackville J:

“The transformation of the judicial role goes well beyond case management and its implicit rejection of the laissez-faire model of adversarial litigation. The courts have accepted new and expanded notions of accountability, some of which are bound up with the principle of consumer orientation.”¹⁰⁷

- 6.36 Martin CJ referred to the civil justice system in Western Australian as the:

“Rolls Royce of justice systems in the sense that it is the best that money, a lot of money, can buy. But there isn’t much point in owning a Rolls Royce if you can’t afford the fuel to drive it where you want to go. You can polish it, admire it and take pride of ownership from it but it doesn’t perform its basic function sitting in the garage.”¹⁰⁸

¹⁰³ Justice Stephen Ryan, “A Significantly Less Adversarial Approach: the Family Court of Australia’s Children Cases Program”, speech to the 22nd AIJA Annual Conference, Sydney 17-19 September 2004.

¹⁰⁴ Andrew Cannon, “Effective Fact Finding”, *Civil Justice Quarterly* 25 (July) 2006 327.

¹⁰⁵ Ibid.

¹⁰⁶ Justice David Ipp, “Reforms to the Adversarial Process in Civil Litigation – Part 1”, (1995) 69 *Australian Law Journal* 69 September 1995 at 705.

¹⁰⁷ Ronald Sackville R, “From Access to Justice to Managing Justice: The Transformation of the Judicial Role”, (2004) 12 *JJA* 5 at 6.

¹⁰⁸ Transcript of Proceedings, Welcome to the Honourable Chief Justice Martin to the Supreme Court of Western Australia, Monday 1 May 2006.

His Honour went on to say:

“It might be time to consider trading our Rolls Royce for a lighter, more contemporary and more fuel efficient vehicle which will get us where we need to go just as effectively and perhaps more quickly.”¹⁰⁹

- 6.37 The assumption here, which is the right one to make, is that most users of the Courts do not want, or do not expect, an overly detailed, thorough and exhaustive process to resolve their disputes but will be content with something less, something where the costs involved are more proportionate to the value of the dispute.
- 6.38 It is time for the Courts and legislators to adapt and listen to what the users of the Courts are demanding. The current system is overly adversarial, which is one of the biggest drivers of disproportionate costs and delay. Many litigators see the other side as the enemy, and believe litigation to be a game of warfare, where preparation for trial is akin to digging trenches and preparing for battle.
- 6.39 Former Chief Justice of the High Court of Australia Murray Gleeson has observed that while “judges have a certain capacity to control the pace and direction, and hence, the expense, of litigation, it is far from complete.”¹¹⁰ In the same speech, the Former Chief Justice acknowledged that it would be wrong to refer to a civil justice “system” as the adversaries in the system are merely looking after their own self interests and it would be “naïve” to think that participants were working towards a common objective. This acknowledgement not only ensures reform is inevitable but the need for reform is immediate.

Comments on improving the accessibility of the courts?

Discovery

- 6.40 Extensive discovery of documents by parties to litigation is a hallmark of the adversarial legal system. In some cases, obtaining access to a defendant’s documents is essential if a claimant is to establish their case and the court is to determine the truth of the matter. However, disproportionate costs (and delays) can be (and frequently are) associated with the provision of discovery. There have been various reforms designed with an eye to achieving the Overriding Purpose by which discovery is limited or is only given after the parties have filed evidence and so the real issues in dispute are apparent.
- 6.41 In IMF’s experience, limited, specific orders for discovery can be made at an early stage in proceedings (often in connection with a court-ordered mediation) which will result in at least the principal “high level” documents relating to the issues in the proceedings being disclosed to the parties. IMF commends the approach taken in the “Fast Track” List of the Federal Court which ordinarily limits discovery to documents on which a party intends to rely or that have a significant probative value adverse to a party’s case and which have been located after a “good faith proportionate search”.¹¹¹ Such orders have materially facilitated the conduct of mediations and have improved the parties’ understanding of, and have narrowed, the issues in dispute.
- 6.42 In March 2011 the Australian Law Reform Commission presented ALRC Report 115 on managing discovery.¹¹² The Report made a range of recommendations which were brought into law by the Access to Justice (Federal Jurisdiction) Amendment Act and the Federal Court

¹⁰⁹ Ibid.

¹¹⁰ Murray Gleeson, Speech to the National Access to Justice and Pro Bono Conference, Melbourne, 2006.

¹¹¹ Federal Court, of Australia, Practice Note CM8, Fast Track, Part 7 – Discovery.

¹¹² Australian Law Reform Commission, *Managing Discovery: Discovery of Documents in Federal Courts*, Report 115, Sydney, 2011.

Rules 2011 (which replaced the Federal Court Rules 1079). Again, without any empirical data, measuring the effectiveness and success of these amendments in removing barriers created by the discovery process is extremely difficult. As the Hon. Justice Emmett has observed, the ultimate weapon in managing the scope and cost of discovery is judicial intervention at an early stage in the litigation process.¹¹³ Until all judges are prepared to actively control the discovery process, the effectiveness of these reforms may be muted.

- 6.43 In March 2012, the Supreme Court of New South Wales introduced new disclosure rules in the Equity Division which provided that the Court would not make orders for disclosure of documents until the parties to the proceedings have served their evidence, unless there are exceptional circumstances necessitating discovery. However, in IMF's view, immediate discovery by both sides is much better than no discovery until evidence is put on.
- 6.44 The use of cost allocation to manage and control discovery was raised by Justice Finkelstein (as he then was) in a paper prepared for the Federal Court of Australia in March 2008.¹¹⁴ He suggested that the court be empowered to order that the requesting party be responsible for the estimated cost of discovery. In the ALRC Report, recommendations were made that the estimated costs of discovery should be paid for in advance by the requesting party and that security for the costs of discovery could also be ordered. Unless very carefully managed by the court and subject to a right by the requesting party to oversee the discovery process and so be in a position to control its potential costs exposure, measures along these lines could be open to abuse by defendants claiming or ensuring that prospective discovery will be hugely expensive, thereby effectively shutting out the claimant by means of a prohibitive costs order. These measures would be unlikely to facilitate access to justice and may in fact erect further barriers.
- 6.45 While anecdotally it can be said that changes to disclosure rules improve access to justice by simplifying procedures and limiting delays and costs, due to a lack of suitable data, it is difficult to assess the real effect of these reforms.

Comments on reform in court procedures in facilitating access to justice
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Case Management

- 6.46 "Case management" is now commonplace in most Australian Courts and continues to evolve and strengthen following the decision of the High Court of Australia in *Aon Risk Services*.¹¹⁵ However, it remains the case that more active and engaged "management" is needed to avoid delay and the incurring of unnecessary costs, although it must be said that some judges have been more willing to apply case management techniques than others. The emphasis should be on *planning* for the most effective way to resolve the dispute, rather than the simple management of proceedings (or the process) where, at present, it is largely left to the parties to determine the course.¹¹⁶
- 6.47 A number of jurisdictions, in Australia and abroad, have introduced "pre-action protocols" and "pre-trial conferences" to attempt to facilitate early resolution of matters before extensive costs are incurred.

¹¹³ Hon. Justice Arthur Emmett, *Reforming Discovery*, Chapter 6 *The Future of Dispute Resolution* (Lexis Nexis Butterworths 2013).

¹¹⁴ R Finkelstein, "Discovery Reform: Options and Implementation," paper presented at the Joint Federal Court of Australia and Law Council of Australia Case Management Workshop, Adelaide, 14 – 15 March 2008.

¹¹⁵ *Aon Risk Services Australia Ltd v Australian National University* [2009] HCA 27 (5 August 2009).

¹¹⁶ Camille Cameron and Elizabeth Thornburg, "Defining Civil Disputes: Lessons from Two Jurisdictions" (2011) 35 *Melbourne University Law Review* 208.

- 6.48 However, despite significant reform of pre-trial case management techniques in recent years, not enough effort is being made to identify and dispose of preliminary issues. Many direction hearings and pre-trial conferences are still essentially about timetabling and setting milestone dates.
- 6.49 Identification and assessment of the Litigation Risks should be conducted at the earliest possible stage of the process and judges must become actively involved in this process.
- 6.50 As Davies says: “Parties, and especially their legal advisers, are often reluctant to settle early if there is some realistic possibility that relevant information in the possession of other parties may materially affect the outcome of the case. So early mutual disclosure of relevant information is likely not only to make early settlement fairer but also to increase the rate of early settlement.”¹¹⁷
- 6.51 Case management has evolved over the last decade in Australian courts in response to concerns about excessive costs and delay. As Spigelman CJ, has said:

*“The objective of case management is to reduce delays and minimise the costs of litigation...Litigants who are dilatory in their preparation, or who otherwise take up too much of the court’s time, waste public resources and exacerbate the delays which other litigants have to suffer. It is perfectly appropriate for judges to take steps to ensure that litigation is conducted efficiently and expeditiously.”*¹¹⁸

Indeed, this is why funded claimants want funders to have the day-to-day management of their litigation.

- 6.52 He said one of the reasons that “managerial judging” had emerged was in response to market failure, caused by the disparity in knowledge between clients and lawyers in relation to the process of litigation, and went on to say:

*“The requirements of specialised skills and the complexity of the process of litigation are such that clients are not able to assess the quality of, or even the need for, a legal service before it is purchased.”*¹¹⁹

- 6.53 IMF submits it is critical that case management is taken to the next level. Judges need to be encouraged to flex their muscles, be active and enquiring and take control of the matters allocated to them to ensure that litigation is being conducted efficiently and expeditiously. This is so particularly in relation to discovery and where there are multiple defendants (where there is a need for increased focus on avoiding duplication in representation).
- 6.54 IMF’s experience as a participant in the civil justice system suggests that despite the advances made by extensive case management in recent years, excessive costs and delays remain prevalent. Case management, although going some way, has not yet achieved its purpose.
- 6.55 The fuller implementation of case management principles needs to work in conjunction with changes in the civil justice system which provide incentives to engage with the process and effective consequences for non-compliance. A focus on changes to the rules and incentives within the system will encourage changes in behaviour to the benefit of the users of the system.¹²⁰

¹¹⁷ Ibid, note 100 at 10.

¹¹⁸ James Spigelman ‘Case management in New South Wales’, Address to the Annual Judges Conference, Kuala Lumpur, Malaysia, 22 August 2006.

¹¹⁹ Ibid.

¹²⁰ Cameron & Thornburg, note 116.

Pre-action requirements and procedures

6.56 In November 2006, the Civil Justice Reform Working Group in Canada released a report titled *Effective and Affordable Civil Justice* (“the Canadian report”) which set out a model for a Case Planning Conference (“CPC”).

6.57 The Canadian report noted that:

“The litigation process must be streamlined through:

- *early identification of issues and interests;*
- *ensuring that the amount of process is proportional to the value, complexity and importance of the case; and*
- *increasing judicial intervention to establish and enforce timelines for completing major litigation events.”¹²¹*

6.58 One of the challenges highlighted by the Canadian report was shifting the “ingrained cultural beliefs and practices” of the legal profession which “will require early and active judicial involvement in cases”.¹²² It notes that the proposed CPC recognised there are many paths to resolution of a dispute, with a traditional trial at the end of a discovery process being just one spoke in a wheel. The CPC – which is an extensive conference attended by the parties in person and their legal representatives *before* they actively engage with the system – sees a judge work with the parties to develop a plan which identifies, very early in the process, the other spokes that might result in a faster and cheaper resolution of the dispute.

6.59 The Canadian report suggests the judge presiding over the CPC should have extensive powers, including the ability to limit discovery, order summaries of the facts and issues, limit the time expended at various steps of the process, making directions with respect to the use of experts (including whether a joint expert should be used on a certain issue) and limiting the length of any trial. Indeed, the report says that the judge should have power to make “any other orders to produce an efficient and proportional resolution of the case”.¹²³

6.60 The Canadian report says that:

- (a) “Earlier understanding of the case and consideration of planning options will assist in achieving better resolutions for the parties”;¹²⁴
- (b) while the process may result in “some front-end loading of time and cost, we believe that these costs will be outweighed by the benefits of an early and meaningful conference”;¹²⁵ and
- (c) the initiative should be considered a success if:
 - “fewer parties refrain from commencing actions or abandon actions because of cost, complexity and delay;
 - more actions are resolved early and to the satisfaction of the litigants;
 - the overall process costs to litigants are reduced to a level proportional to the value, complexity and importance of their dispute;

¹²¹ “Effective and Affordable Civil Justice”, a report by the Civil Justice Reform Working Group, Canada, November 2006, 11.

¹²² *Idem*.

¹²³ *Ibid* at page 14.

¹²⁴ *Ibid* at page 15.

¹²⁵ *Ibid* at page 17.

- the number and length of contested chamber applications is reduced;
- the process is sufficiently affordable that there are an increased number of trials for those matters that need an adjudication, and
- trials are scheduled earlier, take less time and are more focused.”¹²⁶

6.61 Different types of case planning conferences are now found in the Australian civil justice system adopting some or all of the features of the Canadian model.

6.62 IMF submits that there are a range of additional features which would further promote the likelihood of the Overriding Purpose being achieved. These features include:

- (a) *Pre-Litigation budgets*: Detailed legal budgets should be produced by all parties. Those budgets can then be discussed and amended to reflect the project design determined at the case management conference;
- (b) *Limiting interlocutory disputes*: In any case management conference, the judge must ensure that any proposed interlocutory hearings are relevant to the issues as defined in that meeting and that the preparation of the case is focused on evidence that will assist the Court in its determination of the real issues as defined in the meeting;
- (c) *Costs orders*: Adverse costs should be limited to the budget so long as there is no change to the design of the project; and
- (d) *Early high-level discovery*: discovery of “high level” documents should be made as early as possible in the proceedings, with penalties for non – or dilatory – disclosure.

6.63 Provision of litigation budgets will allow the Courts to:

- (a) monitor excessive costing and determine that anticipated expenditure is proportional;
- (b) monitor excessive timelines to ensure that cases are brought on expeditiously and without unnecessary delay;
- (c) better facilitate case management by allowing proceedings to be monitored by reference to timelines and expected expenditure;
- (d) allow the Court to refer to budgets rather than time costing when reviewing lawyers’ claims for solicitor/client costs; and
- (e) quantify party/party adverse cost orders more efficiently than through taxation or assessment.

6.64 The Court’s oversight of budgets is vital and the parties should be encouraged not to spend more than is proportional to the nature of the dispute. By monitoring budgets, the Court will motivate the parties to achieve the Overriding Purpose and de-motivate delay and expense.

6.65 Pre-litigation budgets are an aspect of the new rules of practice and procedure in the United Kingdom enacted following Lord Justice Rupert Jackson’s Cost Review in May 2009. However, the new rules have only been operative for a limited time and it is too early to assess whether court monitoring of budgets means that the budgets are actually adhered to and litigation proceeds consistently with the agreed budgets.

¹²⁶ Idem.

Comments on Costs Awards and Court Fees

Cost Recovery

6.66 In a system where the loser pays the other side's costs, probably the biggest risk in embarking on litigation is assuming the risk of paying the other side's costs if you are unsuccessful. As Zuckerman has observed, "a litigant's worst nightmare is that he will have to pay the other party's costs as well as his own."¹²⁷

6.67 It is critical that policy makers act to make costs and the time involved in the process more predictable at the outset of the process.

6.68 As noted by Peysner (referring to developments in the UK):

*"The traditional response is to compare litigation to war: Bloody and expensive but above all unpredictable. More recently under the influence of the CPR and case management it has become clear that litigation can be more prospectively managed and, indeed many clients demand that their own side's strategy and costs are extensively planned so that both their solicitor's final bill and their demands for interim payments are predicable."*¹²⁸

6.69 IMF makes the following observations regarding costs recovery:

- (i) increased cost recovery, unless carefully targeted, risks becoming a barrier to justice in itself.
- (ii) cost recovery measures are intended to send appropriate pricing signals to litigants, especially well-resourced ones who tie up court resources with "mega-litigation". Increased cost recovery might result in a tendency to curb such litigants' use of taxpayer-funded facilities. But presumably the wealthy litigants who are the source of the mischief are least likely to be influenced by higher costs and charges.
- (iii) if users of the court system are expected to foot a higher proportion of the costs of running that system, they may also expect higher standards of service delivery and outcomes from the courts themselves.
- (iv) unless any cost recovery measures are applied consistently across the Federal and the State and Territory court systems, competition will inevitably develop (or intensify) between the Federal and State systems. This competitive tension might be advantageous to the improved performance of the civil justice system generally.

6.70 It is not only the quantum of costs that concerns consumers of the system but the unpredictability of those costs. The lack of any objective criteria concerning the level of costs that should be reasonable given a case of a particular complexity makes assessment of costs even more difficult, especially to someone with little experience of litigation.

6.71 While fears of adverse costs acts as a deterrent to bringing an action, once it becomes clear that an action will go all the way to trial, the indemnity principle erodes sensitivity to increased costs because litigants know that success will result in the recovery of costs paid and increased spending may increase the chances of success. The other party will typically respond and also increase their stakes, and the costs snowball, thereby increasing risks to all parties.

¹²⁷ Zuckerman A, "Cost capping orders in CFA cases improve costs control but raise questions about the CFA legislation and its compatibility with Art 6 of the European Convention on Human Rights", *Civil Justice Quarterly*, 2005.

¹²⁸ Peysner J, "Predictability and Budgeting", (2004) 23 *Civil Justice Quarterly* 15.

- 6.72 Bret Walker SC, in his article “Proportionality and Cost-shifting”, argues that central to his proposal to assess the amount a loser has to pay a winning party in litigation “is to transform the qualitative and rhetorical nature of ‘proportionality’ into an overtly precise matter of measurable sums of money” and the “object of the exercise is to permit ascertainment sooner rather than later of the amount of costs the loser will have to pay the winner”.¹²⁹ Mr Walker continues:

*“This should enhance decision-making, whether to fight or settle. It is also intended to deprive a deep-pockets litigant of some of the advantage money can buy, by denying the possibility of manoeuvres, complexity and elaboration initiated or provoked by that richer party augmenting the costs payable to that party even if it wins. It ought to tend against the currently perverse incentive by which time-based charges by lawyers reward slowness. It is also hoped that such an approach would reduce the transaction costs as between parties and their own lawyers, by eliminating to a large degree the need for detailed bills of costs to be prepared for presentation to the losing party for payment to the winner. Finally, it may be that, if the figures are appropriate and market conditions permit, the idea would provide a moderate downwards pressure on the charge-out rates for relatively straight-forward litigation work. Above all, the aspects of the proposal which may conduce to some or all of these happy outcomes should also involve a general disincentive on both sides to complicate the litigation more than a case really requires.”*¹³⁰

- 6.73 Mr Walker notes that his proposed approach “owes a deal to some German procedures, but is by no means closely modelled upon them”. Nevertheless, it is worth examining the scheme that has been adopted in Germany and another adopted by New Zealand to make costs more predictable.

- 6.74 In Germany, as in Australia, a successful litigant is normally entitled to recover the litigation costs from the unsuccessful opponent. But unlike Australia, the law in Germany regulates the amount of recoverable costs.¹³¹

- 6.75 Under the RVG,¹³² recoverable lawyers’ fees are fixed by law as a small percentage of the value of the claim, which declines as the value of the claim increases. The fee for a claim of £100,000 would be in the region of £5,000. Cannon says that parties are reluctant to pay in legal fees more than they can expect to recover from the other side.¹³³

- 6.76 There are a number of benefits of the German system, as noted by Zuckerman:

*“The German system has several advantages. First, it removes the incentive to exaggerate the value of claims, because the court fee and the lawyer’s fee are related to the value of the claim and because recovery of costs is in proportion to the sum awarded. Secondly, litigation costs are moderate, and far lower than in England. Thirdly, since litigation costs are predictable there is a thriving market for litigation cost insurance. Most household insurance policies provide cover for litigation costs, so relatively few citizens feel shut out of court.”*¹³⁴

¹²⁹ Bret Walker, ‘Proportionality and cost shifting’, 27 *UNSW Law Journal* 214 at 217.

¹³⁰ *Idem*.

¹³¹ See for more detail on the RVG, Cannon A, “Alternatives to Activity Based Costing”, a paper delivered to the 24th AIJA Conference, Adelaide 16-17 September 2006.

¹³² Statute Regulation of Attorney’s Fees (Rechtsanwaltsvergütungsgesetz = RVG).

¹³³ *Idem*.

¹³⁴ Zuckerman A, “Court Adjudication of Civil Disputes: A public service that needs to be delivered with proportionate resources within a reasonable time and at reasonable cost”, a paper delivered to the 24th AIJA Conference, Adelaide 16-17 September 2006.

6.77 The costs discretion in New Zealand provides a formulaic approach, allowing clients to be informed in advance of what the likely costs – of success or failure – will be. The Rules¹³⁵ ensure that costs are determined by having regard to the proceedings' complexity and significance. One of the five overriding principles (set out in Rule 14) of the New Zealand regime is the "determination of costs should be predictable and expeditious".¹³⁶

6.78 As Beck notes:

*"Instead of relying almost entirely on a general discretion to achieve appropriate awards, it was seen as important to make costs predictable and relatively simple to determine."*¹³⁷

6.79 In summary, the rules limit the recoverable costs which can be awarded to a successful party by conducting a systematic assessment process through which the Court classifies proceedings according to their complexity, and the time which ought to be expended on a particular step. Importantly, the determination does not depend on the actual counsel or time involved but rather is an objective approach which seeks to determine the costs that ought to be considered appropriate given a particular proceeding's level of complexity.

6.80 The rules also make specific provision for situations in which increased costs (including indemnity costs) and decreased costs may be awarded and the rules are subject to an overriding discretion of the court.¹³⁸

6.81 Costs rules play an important role in the civil justice system and appropriate changes in costs rules can effect changes in behaviour to achieve more proportionate outcomes and can be used to enhance equity and efficiency in the civil justice system.

¹³⁵ New Zealand High Court Rules 1 February 2009.

¹³⁶ A detailed description of the Rules is outside the scope of these submissions but contained in a paper by The Hon Justice Venning titled "Alternatives to Activity Based Costing: the New Zealand Approach", which was delivered to the 24th AIJA Annual Conference, Adelaide, September 2006.

¹³⁷ Beck A, "The costs discretion", *New Zealand Law Journal*, November 2001 at 425.

¹³⁸ That said, the Court of Appeal has found that the discretion should be viewed in the context of specific rules and is not unfettered: *Body Corporate 97010 v Auckland City Council*, CA 234/00 (30 August 2001).

APPENDIX 1 – IMF CASE MANAGEMENT HISTORY (30 JUNE 2013)

Independent Auditor's Report to IMF (Australia) Ltd

We have reviewed the attached Statement of Completed Matters of IMF (Australia) Ltd for the period from 19 October 2001 to 30 June 2013 ("The Statement").

The Statement has been prepared for the Directors to assist the Directors in ensuring that the information disclosed in the Statement has been prepared in accordance with the notes to the Statement.

Management's Responsibility for the Statement

Management is responsible for the preparation of the Statement and has determined that the accounting policies used are appropriate to the needs of IMF (Australia) Ltd. Management is also responsible for such internal controls as management determines are necessary to enable the preparation of the Statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express a conclusion on the Statement based on our review. We have conducted our review in accordance with Standard on Review Engagements ASRE 2405 *Review of Historical Financial Information Other than a Financial Report* in order to state whether, on the basis of the procedures described, anything has come to our attention that causes us to believe that the Statement is not prepared, in all material respects, in accordance with the notes to the Statement. ASRE 2405 requires us to comply with the requirements of the applicable code of professional conduct of a professional accounting body.

A review consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, which is not an audit, nothing has come to our attention that causes us to believe that the Statement of Completed Matters of IMF (Australia) Ltd for the period from 19 October 2001 to 30 June 2013 is not prepared, in all material respects, in accordance with the notes to the Statement.

Ernst & Young
Perth
24 October 2013

Statement of Completed Matters

The following is a summary of all matters completed¹ by IMF (Australia) Ltd ("IMF") from 19 October 2001 to 30 June 2013.

Outcome	No of cases	% of total	Total income ² generated from funded cases including cost recovery	Total costs recovered ³	Total income ² generated for funded clients	Total income ² generated by IMF including cost recovery	Net income/(loss) ² generated by IMF	Average funding duration in years
Settled	95	65%	1,117,789,096	114,976,353	758,935,766	358,853,330	243,876,977	2.53
Judgments - Won	14	9%	160,678,143	25,519,942	90,697,990	69,980,153	44,460,211	2.72
Judgments - Lost ⁴	5	3%	-	-	-	-	(3,165,646)	2.35
Withdrawn ⁵	35	23%	228,666	224,766	3,900	224,766	(4,118,560)	1.32
TOTAL PORTFOLIO	149	100%	1,278,695,905	140,721,061	849,637,656	429,058,249	281,052,982	2.29

NOTES TO THE STATEMENT OF COMPLETED MATTERS

1. A completed case is classified as being one where a funding agreement has been signed by a third party and IMF since 19 October 2001 and where IMF has no further funding liability.
2. Income/(loss) recognised from completed matters is calculated on the same basis as IMF's accounting policies as disclosed in the 30 June 2013 financial statements, except for the purposes of this table where it excludes internal overheads and capitalised interest.
3. "Total costs recovered" refers to the recovery of external costs only. It does not include internal overheads and capitalised interest.
4. "Court – Lost" refers to funded cases which were completed by a judgement and IMF's client was unsuccessful. No costs were recovered from these cases, however, costs including adverse costs paid to the winning side, of \$3,165,646 were incurred by IMF.
5. "Withdrawn" refers to cases where IMF terminated the funding agreement with the client prior to the conclusion of the case. Total costs incurred in these cases were \$4,343,326 before the recovery of \$224,766.