



October 13, 2011

VIA EMAIL

Mr. Timothy Beale
Manager, Governance and Insolvency Unit
The Treasury
Langton Crescent
Parkes ACT 2600

RE: Draft Corporations Amendment Regulations 2011

Dear Mr. Beale:

The U.S. Chamber Institute for Legal Reform (“ILR”) is pleased to present its comments regarding the Corporations Amendment Regulations 2011 (“the Regulations”) proposed by the Department of the Treasury (“The Treasury”), which would exempt Third Party Litigation Funding (“TPLF”) providers from regulation as Managed Investment Schemes (“MIS”), but subject them to certain rules to address conflict-of-interest issues.

ILR is a not-for-profit public-advocacy organization affiliated with the U.S. Chamber of Commerce, the world's largest business federation, representing the interests of more than three million businesses of all sizes and sectors, as well as state and local chambers and industry associations. ILR's mission is to ensure a simple, efficient and fair legal system. Since ILR's founding in 1998, it has worked diligently to limit the incidence of litigation abuse in U.S. courts and has participated actively in legal reform efforts in the United States and abroad. Because many of its members have substantial business activities in Australia, ILR is deeply invested in the orderly administration of justice in Australia and the evolution of Australian legal regimes. Further, Australia's decisions on these issues will have a global impact because they will affect multi-national businesses that participate in the Australian economy and establish precedents for other nations.

TPLF – the practice of providing money to a party to pursue a potential or filed lawsuit in return for a share of any damages award or settlement – is an established, but largely unregulated industry in Australia. As a general matter, ILR views TPLF as a very troubling practice that

should simply be banned. ILR takes this position based on the primary threats that TPLF poses:

- *First*, TPLF can encourage speculative and frivolous litigation.
- *Second*, TPLF providers tend to shift control of litigation away from the real parties in interest and their counsel.
- *And third*, TPLF raises a variety of ethical concerns by introducing a profit-motivated stranger – with no fiduciary obligations to the claimant – into the traditional attorney-client relationship.

These concerns arise in every TPLF relationship, but they are particularly pronounced in class actions, both because of the high stakes involved in such cases and because the claimants in class actions often have only limited control (at best) over the prosecution of their claims. However, ILR understands that for a variety of reasons, Australia has concluded that TPLF activity should be permitted. Accordingly, ILR recommends that certain regulatory safeguards be established to protect against the threats introduced by TPLF activity.

In this regard, ILR notes that while there may be some merit in subjecting TPLF activities to the MIS regime or to financial-services regulation, neither of these existing regulatory schemes will adequately

address the threat that TPLF poses. Rather, any approach should be specifically tailored to impose safeguards that protect consumers from unethical and abusive practices by solicitors and TPLF providers, respectively, and to protect corporations from being forced to expend substantial resources and time defending frivolous actions.¹ In addition to license and registration requirements, ILR urges adoption of several other measures (as detailed below), which are intended to ensure transparency and adherence to fundamental ethical standards – and to minimize the potential litigation abuses that flow from the use of TPLF.

1. License And Registration Requirements

TPLF providers should be required to register with, and be licensed by, an appropriate entity. That entity should also be empowered to receive and investigate complaints regarding TPLF activities. Minimum requirements for licensing should mandate that TPLF providers: (i) post a

¹ These are not speculative concerns. The Australian Institute of Company Directors (“AICD”) has said that defending class actions imposes a substantial financial burden on corporations, and has strongly questioned whether permitting third parties to fund such proceedings negatively affects the health of the economy. See Australian Institute of Company Directors, *Submission to Treasury on Corporations Amendment Regulations Relating to Funded Class Actions* (“AICD Letter”) ¶¶ 2.4, 5 (Aug. 17, 2011), at http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-submissions/2011/~/_media/Resources/Director%20Resource%20Centre/Policy%20on%20director%20issues/2011/SUBM_2011_Funded%20Class%20Actions%20Corporations%20Regulations.ashx.

bond (see below); (ii) meet appropriate probity standards; and (iii) demonstrate their financial stability by disclosing, at the time of initial licensing, and annually thereafter, the TPLF provider's most recent audited financial statements. Registration will permit effective oversight of TPLF providers, and designating a government agency to police the providers is appropriate in light of the weaker bargaining position that consumers have in the TPLF process.

This regulatory function should be performed by an administrative agency, not the judiciary. While judges may address issues and problems presented to them by parties, they typically do not perform the sort of day-to-day oversight activities and investigative efforts that are necessary in the TPLF realm – and they are not staffed to handle such responsibilities. Moreover, courts can only address what may be raised about a TPLF provider's activities in a particular case. Proper oversight of the TPLF industry requires a more holistic approach, with a single regulator taking stock of the effects of the entire industry and all aspects of each TPLF provider's operations.

The TPLF regulatory regime should be designed with an eye to the rules that apply to the legal community. ILR believes that borrowing

relevant regulatory concepts from the legal arena (particularly with respect to conflict-of-interest issues) is appropriate given the degree of control that TPLF providers are permitted to exercise over litigation in Australia, including their frequent involvement in directing litigation strategies and making settlement decisions.²

2. Mandatory Disclosure Of TPLF Involvement

A litigant backed by TPLF should be required to disclose to the court and the opposing parties that a TPLF provider is involved in the litigation. TPLF providers' sole interest in any case is to maximize their own profits. The desire to maximize those profits may lead a provider to steer prosecution of the litigation in a manner that is not in the best interests of the consumer claimants or that impedes the progress of the litigation toward resolution. Disclosure of TPLF relationships will ensure: (a) that a neutral arbiter (the court) is available to review the fairness of the funding arrangement in each case; and (b) that the opposing parties are aware of the interests that may be influencing prosecution of the litigation so that they may respond accordingly.

² As discussed below, ILR strongly recommends that TPLF providers be prohibited from exercising such control over funded lawsuits.

3. Automatic Disclosure Of TPLF Documents And Terms

For similar reasons, there should be mandatory disclosure of the specific terms of the TPLF providers' funding agreement. Such disclosure should include any and all documents that the provider reviewed in connection with making any decision to begin or continue funding a case, and it should be produced to the opposing party without awaiting a discovery request. Given the incentives that TPLF creates for questionable litigation, defendants in suits funded by TPLF providers should have the opportunity to review any documents the provider reviewed in assessing the likelihood of success in the case. Because the provider's sole interest in the litigation is commercial – rather than legal – such documents would not be subject to any privilege or protection.

4. Bar On Referrals And Ownership Interests In Law Firms

TPLF providers should be prohibited from referring plaintiffs to attorneys, from owning stakes in law firms, or from accepting investments from law firms.³ Already, the practice of TPLF raises serious conflict-of-interest concerns because lawyers may be more focused on making the TPLF providers happy than addressing the needs of their actual clients.

³ The AICD has similarly urged that law firms be prohibited from establishing related TPLF providers. *See* AICD Letter ¶¶ 1(a)(iii), 2.3.

After all, TPLF providers are repeat players in the legal market; thus, they are a potential source of future revenue for attorneys. Many plaintiffs, by contrast, will never bring another lawsuit. If TPLF providers were allowed to refer clients to lawyers or take ownership interests in law firms, it would exacerbate the already-serious risk that lawyers will focus more on the interests of the providers than those of their own clients.

5. No Involvement Until Parties Have Counsel

TPLF providers should only be permitted to extend litigation funding to consumers who already have an attorney.⁴ Providers should not be free to *create* litigation by approaching plaintiffs who do not believe themselves to be aggrieved, providing them with a claim, and then funding their prosecution of that claim. Moreover, this safeguard will ensure that consumers have someone available who is focused on their interests – i.e., their attorneys – to advise them through the TPLF process. This safeguard would also alleviate the danger that the two repeat players in lawsuits – the plaintiffs’ attorneys and the TPLF providers – will enter joint-referral

⁴ AICD’s letter urges that TPLF providers encourage litigants to seek legal representation prior to entering the TPLF process. However, ILR respectfully submits that such an aspirational statement is not strong enough.

relationships to the disadvantage of consumers, “steering” plaintiffs toward favored counsel or TPLF providers against the client’s best interest.

6. Contracts Limited To Litigant And TPLF Provider

TPLF funding agreements should only be between the litigant and the TPLF provider. A solicitor should not be a party to such a contract and should not be bound to perform any obligations under it.

7. No Control Over Litigation

A TPLF provider should not be permitted to control any aspect of the litigation, or infringe on the autonomy of the solicitor who is prosecuting the litigation. In particular, the TPLF provider should be prohibited from influencing the solicitor’s conduct of a case or the solicitor’s advice to a litigant, and should be prevented from exercising any decision-making authority in the case.

The need for this safeguard is evident from the growing influence of TPLF providers on litigation in Australia. It is our understanding that at least one Australian TPLF supplier goes so far as to determine case strategies, evaluate and approve key witnesses, and conduct settlement

discussions.⁵ Such deep involvement by TPLF providers is a recipe for abuse. After all, many providers do not have proper legal training – and even those who do have such training have no fiduciary obligation to the claimant in the lawsuit. Rather, they are investors. Allowing these lenders to exercise control over litigation essentially puts the proverbial fox in charge of the hen house. While it may appear superficially that the TPLF provider and the claimant have the same interests in the case (that is, to win), the reality is that TPLF providers will make strategic decisions based on their broad portfolio of litigation and their cash needs/risk appetite. That is not the way litigation decisions should be made in Australia’s courtrooms.

8. Cap On TPLF Recovery

There should also be a cap on the gross amount of a TPLF provider’s interest and fees, as well as a cap on the percentage of the recovery that can be taken by a TPLF provider as interest and fees. Litigation exists fundamentally for the purpose of settling litigants’ disputes and vindicating litigants’ rights. Litigation should not be transformed into a

⁵ Vicki Waye, *Conflicts of Interest between Claimholders, Lawyers and Litigation Entrepreneurs*, 19 Bond L. Rev. 223 (2007) (detailing in appendix the responses of six Australian TPLF providers to questions about industry practices).

business that exists largely for the purpose of enriching entities that are not parties to the litigation. Capping the *gross amount* that a TPLF provider can recover in each case would serve this end by ensuring that the provider cannot fund questionable cases on the wager that one windfall payout could recoup all of its expenditures. Similarly, capping the *percentage* of the claimant's recovery that a TPLF provider can receive in each case would ensure that litigation is conducted primarily for the benefit of the litigants and does not become a high-stakes contest of who can gain greater advantage by fleecing the consumer.

9. Requirement That TPLF Providers Pay Adverse Costs Or Sanctions

Just as they earn fees from any recovery that a litigant receives, TPLF providers should also be required to bear part or all of any adverse fees, costs, or other sanctions for frivolous filings that are assessed against litigants they are backing. The logic of this safeguard is simple. TPLF providers make claims possible by investing in them and providing funding to conduct the litigation. Accordingly, they should also bear the costs that

courts award to the opposing party in litigation that arises from – and is supported by – that funding.”⁶

10. Bonds Required Of TPLF Providers

In order to ensure that they can bear the expense of adverse fee and cost awards, TPLF providers should be required to post a bond at the time of initial registration that is sufficiently large to cover such awards. Requiring TPLF providers to post a bond also guards against the danger that foreign TPLF providers will not maintain sufficient funds in-country to meet their obligations.⁷ In fact, two types of bonds are needed. First, all TPLF providers should be required to post a substantial bond as a condition of registering and being permitted to operate. This money would remain in an account administered by the government, with any interest or dividends going to fund enforcement and oversight activities by governmental authorities, and to fund lawsuits by indigent consumers against their funding providers (a sort of “legal aid” for aggrieved

⁶ ILR understands that some advocates have urged the abolition of the English Rule, also known as the “loser pays” rule, for class actions and related forms of aggregate litigation. ILR notes that the spread of TPLF highlights the importance of maintaining this rule because of the danger that in its absence, TPLF providers would back “no risk” class actions against large companies, merely in the hopes of extracting settlements.

⁷ The AICD similarly expresses concern over both domestic and foreign TPLF providers’ ability to satisfy cost orders. *See* AICD Letter ¶¶ 1(a)(iv),(v), 2.5.

consumers). Second, TPLF providers should also be required to post specific bonds for each claim they fund, posting with the clerk of the court a bond in the face amount of 25 percent of the damages sought, in order to ensure that the provider has sufficient money to satisfy any adverse cost awards. This bond may be released at the conclusion of the case, and after the provider satisfies any order for costs issued by the court.

Requiring TPLF providers to post a substantial bond in connection with the registration process will ensure that they have reasonable financial strength. These bonds will also fund much-needed oversight and enforcement activities in the litigation funding market. Requiring providers to post an additional bond with the court clerk for each case funded, equal to 25 percent of the amount claimed by the consumer, will ensure that the TPLF provider has sufficient funds to satisfy any adverse costs awarded.

11. Requirement To Fund A Case Through Conclusion

In order to protect consumers, TPLF providers must be prohibited from abandoning a litigant during a case. Thus, once a TPLF provider begins funding a case, it should be required to continue funding until the case is concluded by dismissal, final judgment or settlement.

This safeguard would induce funding companies to analyze potential investments carefully. In addition, it would help ensure that TPLF actually achieves its supposed public-policy goal: to increase plaintiffs' access to the courts. Finally, this safeguard would protect consumers by preventing TPLF providers from exerting influence over the direction of a lawsuit by threatening to cut off funding.

12. Bar On Selling Interest In A Case

TPLF providers should also be prohibited from selling to other investors any derivative interest or participation in any cases in which they have advanced funds. This safeguard would prevent TPLF providers from pooling and securitizing their investment in any litigation, and thereby off-loading any risk to third-party investors. Requiring providers to keep their case investments in their own portfolio will encourage them to analyze any claim before agreeing to fund it, thereby reducing the risk that TPLF will increase the volume of frivolous lawsuits.

13. Bar On Assignment Of Proceeds

In cases where litigants utilize TPLF, they should be prohibited from assigning the proceeds of their claims beyond the initial assignment to the TPLF provider. This safeguard is necessary because litigants should not be

permitted to collude with TPLF providers to generate proceeds for third parties. Rather, TPLF should exist to help indigent consumers prosecute meritorious claims in which the consumers have a direct stake.

Conclusion

If TPLF activity is to be permitted in Australian judicial proceedings, ILR believes it is critical to closely regulate TPLF providers in order to protect consumers and preserve the integrity of Australia's judicial system. The measures set forth above are intended to preserve and protect the traditional attorney-client relationship and to prevent litigation abuse.