August 16, 2010

DEVELOPMENTS AND UPDATE ON LITIGATION FUNDING IN AUSTRALIA

This report provides an update on developments in litigation funding in Australia. The discussion also provides background information on how litigation funding is conducted in Australia, the current views of interested parties and the prospects for regulation or other reforms.

I. RECENT DEVELOPMENTS

Post-Multiplex Developments

Since the April 2010 announcement by the Minister for Corporate Law that the Government intended legislatively to overrule the Federal Court’s decision in the Multiplex case – that funded class actions were Managed Investment Schemes (MISs) as defined in the Corporations Act 2001 (the “Act”) – action by the Government has been much awaited.

The Government’s original announcement has been understood as a stop gap measure intended to cause the Australian Securities and Investment Commission (ASIC) to clarify that litigation funders (“LFs”) are not MISs as defined in Chapter 5(c) of the Act. ASIC did take action and issued a temporary exemption from the Act’s Chapter 5(c) requirements for class actions commenced after November 4, 2009.\(^1\)

Following the Minister’s April announcement, early indications were that the Government would amend Chapter 5(c) to specify that litigation funding arrangements were not MISs within the meaning of the Act. The Minister

\(^1\) The temporary exemption was to have expired on June 30, 2010. ASIC does not appear to have extended it and apparently will review proposed LF-funded class actions on a case-by-case basis.
indicated as much in a speech in May 2010. In that speech, the Minister also stated that the Government would clarify that LFs would not require a Financial Services License (FSL) to operate. This was understood as promoting the objective of increasing access to justice by providing further incentive for new entrants to the industry.\(^2\)

While the Minister expressed a desire to avoid a “heavy regulatory burden” on LFs, he also stated in April and May that the Government is “considering regulation to manage potential conflicts of interest through guidance issued by ASIC.” According to the Minister, “There may be some situations in which conflicts of interest may arise, such as where the class action lawyer and funder are assessing proposed awards or settlements. In such instances, it is important to ensure that appropriate arrangements are in place to protect consumers and ensure that their interests are paramount.”

Despite the speculation and these public statements, the Government has taken no action and is not expected to do anything until after the federal elections called for August 21. The recent replacement of Prime Minister Rudd by Julia Gillard is generally thought to be the reason behind the lack of any further action by the Government on this issue.

If the Labor Government is reelected, they will almost certainly continue down the path announced in the Minister’s April and May speeches. On the other hand, indications are that a Liberal Party government would be less inclined to take measures that encourage class actions and other third party funded litigation.

**Federal Court Developments**

To date, the sole action that has been taken in Australia by any government body to address perceived issues with litigation funding was a recent practice note on class actions issued by the Federal Court. The court now requires that parties disclose if they are using a LF. This is intended to prevent skirmishes (as in past cases) over whether plaintiffs are required to disclose this information.

Another issue that may arise in the courts is whether security for costs will be required to be posted by plaintiffs in a class action proceeding. While this is

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2 This statement apparently caused the biggest player (IMF) concern as it already has a FSL. IMF saw this development as opening up the market to more competition.
fairly common in practice, it is not yet required in class actions. Whether security will be required is normally decided on a case-by-case basis by the presiding judge.

A related, more difficult question is whether security will be required in the case of a single named plaintiff (in a class action or any other suit). Typically, individual plaintiffs are not required to post security for costs so there may be no logical reason for a LF to have to do so.

Multiplex settlement

A settlement in the Multiplex class action was publicly announced on July 21. The court approved settlement the next day.

This case, which also led to the Government’s announcement overruling the court’s decision classifying LF arrangements as MISs, involved allegations that Multiplex breached its continuous disclosure obligations in 2004 and 2005 in connection with a construction project in London. The court approved a settlement of $100 million plus $10 million for legal fees of class action lawyers from Maurice Blackburn. The plaintiffs were claiming $200 million. Reportedly, LF ILF Partners is to receive approximately 35 percent of the proceeds before distributions to the shareholders.

Though 120 investors were represented, reportedly 99 percent of the recovery was to go to 12 institutional investors. According to a Maurice Blackburn spokesman, the settlement proved that class actions worked and showed the “absolute inadequacy” of a $32 million deal brokered for investors by ASIC in 2006. Of the ASIC fund, $20 million reportedly went to investors who were precluded from participating in the class action.

II. UPDATE ON OTHER ASPECTS OF LITIGATION FUNDING IN AUSTRALIA

Major LFs Active in Australia

The major LFs active at present are:

**IMF (Australia) Ltd** – The biggest LF and publicly listed, it also owns a subsidiary company called Financial Redress Pty Ltd, which according to its website specializes in recovering compensation from financial institutions for “excessive charges or mis-selling.” This LF has been involved in a number of
notable cases in Australia, reflecting its concentration on this jurisdiction. Recent examples include the following:

- a class action against Bauxite Resources, with a digitally-organized class of record-breaking size;
- a class action against Sons of Gwalia that received a $17 million verdict entitling shareholder creditors to rank equally with other creditors for distribution from insolvent companies; and
- a suit against Opes Prime which resulted in a $15 million settlement.

IMF is also funding an appeal by 70 Lehman Brothers clients, including charities and local councils, two class actions on behalf of members of the Great Southern Cattle Projects against Great Southern group companies concerning the cancellation of interests in two cattle projects in return for shares in Great Southern Ltd., and a claim against the Commonwealth of Australia concerning the conduct of certain Therapeutic Goods Administration officers against Pan Pharmaceuticals.

**International Litigation Funding (ILF)** – This LF is Singapore based, and is owned and controlled by Australian and Canadian investors. ILF is behind the Multiplex case, which just settled (see above). They are funding at least one other proceeding in Australia at present, including, for example, a $450 million class action against Australia National Bank relating to toxic debt instruments. Maurice Blackburn will run the CDO-related class action on behalf of most of the big institutions and industry funds.

**Commonwealth Legal Funding** – This LF is based in Nevada and is active in Australia. For example, CLF partnered with Canadian firm Siskinds to replicate IMF’s class action against Centro Properties and compete with IMF for claimants.

**Litigation Lending Services** – This is a smaller player that handles mostly insolvency cases. They also recently funded a class action by travel agents against the airlines (relating to fuel surcharges).

LF rates appear to vary between 20 percent and 40 percent of the recovery. Some agreements also may vary rates according to how big the individual plaintiff’s shareholding is. Thus, plaintiffs with larger shareholdings are

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3 The Canadian-based law firm Siskinds, one of the largest plaintiffs’ firms in Canada, is an investor in ILF.
charged a lower percentage rate (of their share of a recovery) than smaller shareholders.

The typical deal appears to be that the LF agrees to cover all project costs including lawyers’ fees. Upon resolution, each plaintiff contributes its prorated share of the project costs plus its share of the LF’s fee or commission for “project management.”

International Activity

Several of the LFs active in Australia have international ties (ILF, CLF).

IMF appears committed to replicating its model elsewhere and has been looking at other jurisdictions. IMF may be most interested in funding cases where they can leverage off what they have already done in Australia. Examples might be cartel cases and cases against companies listed in multiple jurisdictions. They will of course require a local legal framework that permits third-party funding of the type they offer.

While IMF’s 2008 withdrawal from Irish venture CFI with Maurice Blackburn may reflect a present interest in focusing primarily in Australia, where it has increasing commercial opportunities and new competitor-entrants to the litigation finance business, its recent co-financed class action with Allianz in London suggests that it has not abandoned its international ambitions. In fact, IMF has plans to enter the U.S. market.

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4 For example, in November 2009, IMF submitted an application to the Hong Kong law reform commission.

5 Allianz Litigation Funding, the UK branch of Munich-based Allianz ProzessFinanz GmbH, began funding claims in Germany, Austria, and Switzerland in 2002 and opened its London office in 2007. Allianz contributed to the formulation of a draft code of conduct, to which the Civil Justice Council proposes all funders should adhere.

6 A March 5, 2010 IMF press release announcing the new Uniloc funding agreement called it “the first major agreement in what is expected to be regular funding transactions in the U.S. and the UK arising from recent marketing campaigns by IMF in those countries.” A recent IMF presentation to investors included in its “future outlook” a target of $2 billion by June 30, 2011, marketing plans, and UK and U.S. opportunities.
Type of Cases in Australia and Trends

Securities class actions have been popular in Australia because of the nature of the causes of action – multiple plaintiffs, large potential awards, and no requirement to prove intent. Companies can be held liable even for inadvertent false or misleading statements.

In these cases, the principal issues will relate to causation and the measure of damages. On causation, plaintiffs are likely to push courts to accept a “fraud on the market” standard and thus not require plaintiffs to prove individual reliance on the false or misleading statement.

Class actions against alleged cartels will also continue to be brought from time to time. One major difficulty in these cases is proving collusive behavior. Class action cases will typically need to bootstrap onto government prosecutions.

Consumer actions may be a growth area. A case is currently being prepared against 15 major banks, including the big four Australian banks plus the regional banks and two overseas based banks including Citigroup. The Australian law firm Maurice Blackburn is already running an Australian version of an American class action against an air cargo cartel, in which the judge threw out foreign claimants. The firm was also involved in the start up of Claims Funding International (CFI) a Dublin-based funder, to finance and organize a European version of the same suit (See footnote 4). The establishment of CFI was prompted by the lack of a recovery in the U.S. suit by non-U.S. parties. An $87 million settlement reached by Air France-KLM and Holland’s Martinair with a class of U.S. consumers did not reimburse direct purchasers outside of the U.S. A CFI spokesman said they plan to pursue a claim ranging from €335 to €500 million or more against the companies. CFI is currently managing litigation on behalf of a large group of businesses to recover losses sustained as “victims of the global air freight cartel.” Together with French subsidiary Equilib, CFI is seeking European companies that purchased international air freight services between 01/01/2000 and 14/02/2007 with a total volume of more than €1 million to join the class action. The suit is led by U.S. plaintiffs’ lawyer Michael Hausfeld of Hausfeld & Co LLP. Other plaintiffs’ counsel includes Kaplan Fox & Kilsheimer LLP, Labaton Sucharow LLP, and Levin, Fishbein, Sedran & Berman.

The class claims the banks overcharged millions of customers $5 billion in penalty and late fees over the past six years. IMF is funding more than 10 class actions, led by Maurice Blackburn, against 12 banks (ANZ, Bank of Queensland, Bank SA, Bankwest, Bendigo Bank, Citibank, Commonwealth Bank, HSBC, NAB, St. George, Suncorp, Westpac) to recover at least $400 million in overcharged “exception fees.” Exception fees typically range from $25 to $60 per transaction and include honor fees (when a customer
prospective claim concerns bank fees during a four-year period. If this case is successful, more consumer-type cases brought against groups of companies could follow (see below).

There are also likely to be more cases brought against financial services firms, financial advisers and against originators or managers of financial products. Claims would typically relate to disclosures by financial service firms and advisers as to the performance of these products. A current class action against the firm Westpoint involves financial products that were recommended by the defendant financial advisers. This case appears to be funded at least in part by a LF.

The reason for projected growth in this area is the advent of superannuation as the method of choice for retirement planning. As a result, individual investors are directly involved in the markets saving up for retirement.

Another recent development has been LF involvement in funding IP cases, especially patent infringement actions. One example is a series of actions for patent infringement brought by a company called Uniloc. The actions are being funded by IMF and involve lawsuits in multiple jurisdictions. Thus far, cases have been brought in the Federal District Court in Rhode Island (against Microsoft) as well as in the Eastern District of Texas (three actions against approximately forty plaintiffs). According to a recent IMF press release, announcing new funding for U.S. actions, “IMF’s funding will be used by

overdraws on a bank account or exceeds an agreed overdraft limit); dishonor fees for bounced checks; late payment fees for credit cards or loan accounts; and fees for overdrawing on a credit card. IMF has set up a web site (http://www.financialredress.com.au/) to attract class members who have paid at least one exception fee over the past six years. The central legal argument is that a party to a contract, when it seeks damages for breaking a contractual term, can only recover a reasonable pre-estimate of its actual costs. IMF is expected to contend that the fees were not legally enforceable and customers should therefore be entitled to a refund. Claimants seek repayment of fees plus interest from the date of deduction. IMF subsidiary Financial Redress will organize each class action. Personal claims are expected to average $2000, while business claims are likely to average $5000. See Adele Ferguson and Michael West, Fee Gouging: Banks Face Huge Class Action, SYDNEY MORNING HERALD, May 12, 2010, available at http://www.smh.com.au/business/fee-gouging-banks-face-huge-class-action-20100512-uw8h.html.

The case in Uniloc v. Microsoft ended in a record $388 million jury award against Microsoft that was subsequently overturned. The case is now on appeal by Uniloc before the U.S. Federal Circuit.
Uniloc for its patent enforcement and licensing program throughout the United States.\textsuperscript{10}

A potential “match made in heaven” would be LF funding of cases brought by patent trolling firms. LF funding could encourage an even larger volume of cases to be brought. One potential disadvantage in Australia is the requirement of security for costs. This factor may, however, simply affect the calculation of how many successful cases would need to be achieved to provide a satisfactory return for the LF.

\textit{Contingency Fees in Australian Cases}

There is a historic concern in Australia about permitting contingency cases. The concern is that this type of arrangement could compromise the lawyer’s obligation to serve the client’s best interests.

Still, renewed debate on this issue is possible. Some could argue that permitting contingency fee arrangements would introduce additional competition and potentially lower the fees of LFs.

To date, litigation funding has been seen as more acceptable ostensibly because the client’s interests are still “protected” by the lawyer. This reasoning ignores that the lawyer still relies on the LF to be paid in these cases. Moreover, in at least some arrangements with LFs, final payment of a portion of the lawyer’s fees is contingent upon a successful recovery.

\textit{Legal Aid in Australia}

Legal aid in Australia generally has been recognized as insufficient to ensure access to justice. Despite a recent Government announcement that it would be contributing an additional $154 million in funding beginning on July 1, 2010, legal aid is still regarded as inadequate for the needs of the community.

It is also viewed as completely distinct from litigation funding. Legal aid is not available in cases where a LF has an interest. Legal aid is also used primarily in criminal cases and small civil proceedings such as family law cases. No legal aid is available for cases like class actions. As a consequence, there is no overlap between LF and legal aid.

\textsuperscript{10} The amount of funding announced by IMF was US$5 million (See IMF (Australia) Ltd 5 March 2010 Press Release, footnote 7).
The Legal Reform Commission of the State of Victoria has proposed to establish a government-funded LF that would take a percentage of the recovery like any litigation funder. The idea was to increase competition and promote increased access to justice. However, concerns have been raised as to a government department’s ability to decide what cases to back.

Insurance

Class actions funded by LFs appear to have made traditional insurance policies unprofitable. AIG has already moved to split director and officer coverage from company coverage. Companies wanting to cover directors and officers, and companies themselves may need increasingly to purchase two policies. This will be advisable in any case because policy limits may be reached with awards against companies leaving nothing to cover directors or officers named in a suit.

A related development is plaintiffs expanding the parties they sue to include advisers and even attorneys (where there are claims of false or misleading statements in prospectuses). One of the reasons for this is to gain access to funds from parties’ insurance policies. This is especially true in the case of companies in financial trouble. A recent case against the company Centro is an example in which a series of cross claims have been filed greatly increasing the complexity of the proceeding.

III. OPPOSITION AND CALLS FOR GREATER REGULATION

Opposition to Litigation Funding in Australia

To date, there is no major company or business group that is “on the record” expressing opposition to or fundamental concerns with litigation funding in Australia. One reason is that some interested parties have a stake in the system. For example, while institutional funds may be sued they also benefit from suits being brought more easily against companies violating the securities laws.

The nature of cases brought thus far may have a bearing on this as well. No company would want to be seen as asserting the right not to be sued by small investors for making false or misleading statements. While some companies and industry groups may have private concerns, no one has been willing to lead a public charge against LFs.
This situation, however, may change depending on the outcome of the planned class action against the banks described above. Especially if the bank class action succeeds there may be increased concerns expressed by the banking industry and other sectors like the utilities, airlines, and telecommunications companies that may also have exposure to these types of cases. And, since these types of cases may simply focus on the reasonableness of fees charged and not involve any allegations of deceptive or fraudulent practices there may be less hesitation to take a public position on the need for further regulation in this area.

Outside of industry, most sectors of Australian society seem to be supportive of or at least neutral on the idea of litigation funding. Much of the press and academic literature is pro-consumer and thus in favor of LF. Moreover, since the High Court approved the use of LF in the *Fostif* case most stakeholders appear to have accepted that it is a mechanism here to stay.

Another reason for the general support is that there have not been many cases brought involving speculative or frivolous claims. The Australian judicial authority to award costs to the prevailing party in a civil litigation has no doubt played a role in this.\(^{11}\)

*Possible Regulation of the LF Industry*

In view of the degree of general support for LF arrangements, the principal focus of discussion in Australia has been on whether and how to regulate the industry.

Although the Standing Committee of Attorneys General recommended greater regulation in 2006, nothing has been done legislatively to date. The only development has been the Federal Court’s practice note, mentioned above.

There are probably several reasons why the Government has not acted to regulate the industry despite the Standing Committee’s recommendations.

\(^{11}\) Nevertheless, there have been a few securities cases that in the minds of some probably should not have been brought. These include a class action against Telstra brought by Slater & Gordon, which a LF had declined to finance and which only yielded a $5 million settlement. Another example was the class action against AWB Ltd. The allegations there involved omissions, not false or misleading statements, and was not seen as a strong case. The matter has settled but the terms of the settlement have not yet been made public.
First, as evidenced by Minister Bowen’s April 2010 announcement, the Labor Government has been generally pro LF on access to justice grounds. It no doubt sees little political mileage in pushing for greater regulation.

Second, there also are practical considerations. The Australian Government created the situation whereby individual small Australian investors have become directly involved as investors in the markets – through its Superannuation legislation requiring people to set up their own “super” schemes. Taking steps to restrict investors’ ability to recover losses is no doubt seen as a difficult step to justify.

As previously discussed, however, the planned class action against the banks could change the landscape by providing a reason for this major industry – and potentially others – to take a more public stance on the need for regulation and some restraints.

**Update on Class Actions in Australia/ Possible Areas for Reform**

In several respects class actions are significantly easier to bring in Australia than in the United States. For one thing, there is no class certification requirement. To commence a proceeding, a plaintiff need only name seven or more persons likely to be in a class. There is also no requirement that the party bringing the action actually signs up other members of the class or obtain approval from the court to proceed. The party bringing the case simply must allege a common question of law or fact. It is then the defendants’ burden to challenge the class. In view of these relaxed requirements and the availability of litigation funding, Australia is undoubtedly the most receptive jurisdiction in the region for class actions at this point. Other countries may allow class actions in some circumstances; what appears to be generally missing is a funding mechanism.

In Australia, there appears to be limited debate on whether the system of class actions should be reformed in any way. A Commonwealth Attorney General’s report has raised some questions as to the need for reforms to this system. Several prominent lawyers have also publicly urged that class certification be required. Otherwise, there does not appear to be any stakeholder in Australia calling for reform of the system.

There could be room for further empirical study on class actions and on the activities of LFs in Australia. Points that are not generally understood include:

- the amounts typically needed to fund class action cases;
the recoveries that are being realized by the LFs; and
the amount taken out by the LFs.

Development of these data could provide further support for calls for reform. For example, if the recoveries or rates of LFs are shown to be exorbitant or unreasonably high in view of the investment, there is likely to be more interest in reining in their practices.