



U.S. CHAMBER  
Institute for Legal Reform

# Third Party Litigation Financing in Australia

*Class Actions, Conflicts  
and Controversy*

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OCTOBER 2013





**U.S. CHAMBER**  
**Institute for Legal Reform**

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# Table of Contents

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Executive Summary ..... 1

Introduction..... 3

Access to Justice: Limitations of Litigation Funding ..... 7

Litigation Increase: Funding Increases the Scale of Class Actions ..... 12

Conflicts of Interest: Inherent in Third Party Litigation Financing ..... 15

Open Class Actions: Prejudice to Non-Funded Group Members ..... 19

Conclusion..... 30

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# Executive Summary

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Third party litigation financing is relatively young in Australia, and the industry has been largely unregulated. Litigation funders often claim that they provide increased access to justice in an attempt to justify both the role they play, and the limited oversight in the area. However, in reality, litigation funders choose cases solely to maximise their profits, which means that only a narrow category of cases are funded, and funded class actions are being tailored to suit the needs of large institutional class members. The lack of oversight of the industry is not justified by the limited, and often overstated, role played by litigation funders in providing increased access to justice.



Recent outcomes in class actions suggest that oversight is required to deal with a number of challenges that third party litigation financing presents to the administration of justice in Australia, including:

- **Increased Litigation:** Empirically, third party litigation financing increases the scale and complexity of litigation, and has the potential to increase the number of unmeritorious claims instituted.
- **Conflicts of Interest:** Third party litigation financing heightens the risk that lawyers will be restrained from acting in the best interest of their clients, as litigation funders are free to contract for almost exclusive control of the litigation, and the long term nature of the relationships between litigation funders and law firms discourages lawyers from making decisions adverse to the interests of litigation funders (even when those decisions are in the best interests of clients).

- **Prejudice to non-funded group members:** There is a danger that the commercial incentives introduced by third party litigation financing lead to settlements which are structured to favour the interests of litigation funders and/or group members who have entered into funding agreements, to the prejudice of group members who have not entered funding agreements.

Any regulation of third party litigation financing needs to consider these issues, and other controversies surrounding litigation funding outlined in this paper.

*“With the business model that [litigation funder] IMF has, which is perfectly legitimate ... all that has little to do with access to justice.”*

*— Justice Sackville,  
August 2012<sup>1</sup>*

Former Judge of the Federal Court of Australia and Acting Judge of the Court of Appeal of the Supreme Court of New South Wales

# Introduction

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Litigation funding schemes were described by the previous Australian Federal Government as schemes involving a person or entity that is not a party to litigation, and has no direct interest in its outcome, paying the costs in return for a percentage share of the proceeds if the litigation is successful.<sup>2</sup> More colloquially, third party litigation financing (TPLF) has been described as *“financiers bankroll[ing] court cases for a percentage of any damages.”*<sup>3</sup>

In Australia, third party litigation funders or investors (Funders) primarily fund large scale litigation, including corporate insolvencies, commercial and contractual disputes and securities and consumer protection claims.<sup>4</sup> The continuing prevalence of TPLF in Australia has promoted the use of representative or group proceedings—‘class actions’—as a means of pursuing claims, and the involvement of Funders in class action proceedings has added multiple layers of complexity to the issuing, running and resolving of such disputes.

Against this backdrop, this paper explores some of the controversies surrounding TPLF as it occurs in Australia, using examples drawn from recent litigation, to demonstrate the value of increased regulatory oversight of the industry.

## Major Players in the Australian TPLF Market

Presently, the Australian TPLF market includes a number of Australian and off-

shore Funders:<sup>5</sup> see Figure 1: Current Funders in the Australian Market, below. The absence of regulatory barriers to entry into the Australian funding market, and the potential profits to be made by Funders, have recently encouraged a number of new Funders to commence operations in Australia. The involvement of more Funders will inevitably drive more class action litigation as they compete for market share.

In a typical TPLF arrangement, the Funder will contract with one or more potential litigants. The Funder pays the litigation costs (such as lawyers’ fees and disbursements) and usually indemnifies the funded litigant from the risk of paying the other party’s costs if a claim fails. If the claim succeeds, the Funder receives a percentage of any settlement or judgment, usually after its costs have been reimbursed.<sup>6</sup> IMF (Australia) Ltd (IMF), Australia’s largest Funder, indicates that its commission from compensation awarded to class action group members normally ranges between 20% and 45%.<sup>7</sup> IMF listed on the Australian Stock Exchange (ASX) in 2000 and was the only

Funder in Australia to hold an Australian financial services licence (AFSL) until it applied to have its licence cancelled in April 2013.<sup>8</sup> Hillcrest Litigation Services Ltd (also ASX listed) suggests that a Funder typically receives 30% to 45% of the amount ultimately recovered under a funded claim<sup>9</sup> and LCM Litigation Fund Pty Ltd suggests that its commission is between 35% and 50%.<sup>10</sup> Those returns have not reduced despite new entrants to the market. Despite the high investment returns on offer to Funders and the significant impact they have on the administration of justice within

Australia, the Australian TPLF industry remains largely unregulated.

Figure 1, below, lists the major players in the Australian TPLF industry. Three things are apparent from this table. First, most Funders operating in Australia are privately held, and do not make their financial information publicly available. Second, several of the largest Funders operating in the country are incorporated outside of Australia. Third, most Funders on the list are reported to be funding class action litigation.

**Figure 1: Current Funders in the Australian Market**

| Funder                                                  | Listed?        | Incorporated in Australia? | Reported to be funding class action(s)? | Public accounts or financial information? |
|---------------------------------------------------------|----------------|----------------------------|-----------------------------------------|-------------------------------------------|
| IMF (Australia) Limited (ACN 067 298 088)               | ✓              | ✓                          | ✓                                       | ✓                                         |
| Hillcrest Litigation Services Limited (ACN 060 094 742) | ✓              | ✓                          | ✗                                       | ✓                                         |
| LCM Litigation Fund Pty Limited (ACN 078 747 092)       | ✗              | ✓                          | ✓                                       | ✗                                         |
| Litigation Lending Services Limited (ACN 129 188 825)   | ✗              | ✓                          | ✓                                       | ✓                                         |
| Quantum Funding Pty Limited (ACN 129 864 713)           | ✗              | ✓                          | ✗                                       | ✗                                         |
| Claims Funding Australia Pty Limited (ACN 158 551 967)  | ✗              | ✓                          | ✓                                       | ✗                                         |
| Comprehensive Legal Funding LLC (ARBN 132 369 003)      | ✗              | ✗<br>USA                   | ✓                                       | ✗                                         |
| International Litigation Funding Partners Pte Limited   | ✗              | ✗<br>Singapore             | ✓                                       | ✗                                         |
| Omni Bridgeway                                          | ✗              | ✗<br>The Netherlands       | ✓                                       | ✗                                         |
| Argentum Investment Management Limited                  | ✗ <sup>1</sup> | ✗<br>UK                    | ✓                                       | ✗                                         |

<sup>1</sup> The Argentum Group is made up of three companies: Argentum Capital Limited, Argentum Investment Management Limited and Argentum Litigation Services Limited. Argentum Capital Limited is listed on the Channel Islands Stock Exchange: Argentum Group website, available at <http://www.aglitigation.com/about-us/overview/>.

## Class Actions, Conflicts and Controversy

A number of current issues relating to TPLF support arguments in favour of increased regulatory oversight of the TPLF industry in Australia, with several emerging issues also creating concern. This paper addresses each of these issues in the following sections:

- **Access to Justice:** The notion that TPLF promotes access to justice has long underpinned arguments in TPLF's favour and has been cited as the justification for no regulation at all, or at most, a minimalist approach to its regulation. However, an analysis of the methods employed by Funders in determining what types of claims to pursue and how to pursue them suggests that the extent to which TPLF provides access to justice has been considerably overstated by its proponents. Accordingly, any such claims ought to be closely scrutinised in formulating a proportionate regulatory approach.
- **Increasing Litigation:** The availability of TPLF increases the scale and complexity of litigation and carries with it the risk that unmeritorious claims will be funded in the hope of achieving a settlement. This section considers statistical data on the impact of TPLF on the court system and practical examples of this impact.
- **Conflicts of Interest:** Lawyers must have undivided loyalty to their clients. This fundamental fiduciary obligation governs the lawyer/client relationship. However, the nature of TPLF increases the risk that a lawyer's loyalty will be divided between the client and the Funder. To date, these risks have not been subject to effective oversight.
- **Prejudice to non-funded group members:** A practice of employing equalisation factors in class action settlements has developed, effectively reallocating the burden of a Funder's premium so that it is shared by all group members irrespective of whether they decided to enter into a funding agreement. Little notice of proposed equalisation factors has been given to group members and their fairness has not been adequately considered. This section considers some of the issues to which equalisation factors give rise, including whether non-funded group members are adequately represented in the settlement of funded class actions; whether scrutiny should be given to the reasonableness of premiums; the potential for conflicts of interest between funded and non-funded group members; and the potential for abuse of class action settlements by Funders to extract a return beyond that to which they are contractually entitled.



The paper concludes by briefly highlighting various other issues relating to TPLF that are as yet unresolved, but certainly should factor into any analysis of an appropriate oversight regime for TPLF, including what happens if a Funder collapses or walks away during the course of a class action; how the problem of competing class actions will be addressed; and whether Funders owe (or should owe) duties to funded and/or non-funded group members.

*“ Carried out prudently and in full consultation with stakeholders, it is likely that regulatory reform will prove beneficial to the industry. It will provide certainty for funders, their clients and lawyers; improve the responsible provision of litigation funding in Australia; and enhance its providers’ prospects. ”*

# Access To Justice: Limitations of Litigation Funding

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The notion that TPLF promotes access to justice has long underpinned discussions about regulatory settings in the funding industry. When the former government exempted Funders from the Australian financial services licencing regime, access to justice was advanced as the justification for this approach.<sup>12</sup> However, in recent years a number of eminent commentators have questioned the extent to which TPLF delivers on this promise.<sup>13</sup> Indeed, last year Justice Sackville observed:

[T]he business model that IMF has, which is perfectly legitimate ... has little to do with access to justice ... The Government justified the lack of regulation on funders because it improves access to justice, but access to justice is not really advanced when you have a business model that says 'we will only provide assistance for those cases that are going to win.'<sup>14</sup>

The commercial incentives driving the business model of IMF and other Funders are such that both the type of claims they select and the manner in which those claims are pursued provide limited access to justice for those who would otherwise not be able to afford it while nevertheless

having a significant impact on the conduct of litigation within Australia.

## Funders Target Very Specific Types of Claims

Funders have been open about the highly selective nature of their support for legal proceedings. Of the 763 cases considered by IMF between February 1999 and June 2007, 90 were selected for funding, 18 of which were group proceedings.<sup>15</sup> Based on the funding criteria published by Funders and the cases that they have pursued in the courts, it is clear that they have tended to pursue high value, low risk claims in a narrow range of areas.<sup>16</sup>

## FINANCIAL THRESHOLDS ARE HIGH

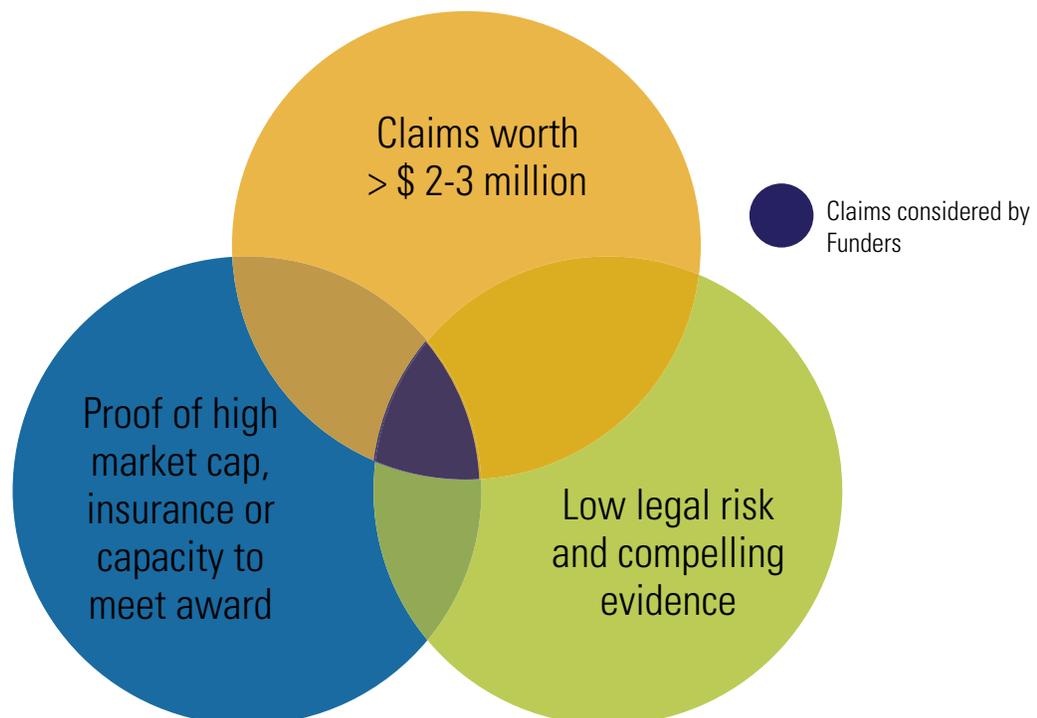
Funders must be satisfied that the claims they choose to support will generate an adequate return on investment. As a consequence, claims must meet high value thresholds in order to be considered for funding, and claims that seek injunctions, declarations or other non-monetary relief are automatically excluded.<sup>17</sup> Claims must also satisfy cost versus return thresholds. IMF has indicated that it only considers claims with a value greater than \$2 million,<sup>18</sup> and other major Funders also adopt claim thresholds in the \$2-3 million range.<sup>19</sup> Funders additionally require proof that a prospective defendant will be able to meet a damages award. In the context of securities class actions, IMF has indicated that the prospective defendant must have a market capitalisation of at least \$100

million or sufficient insurance before it will consider pursuing an action.<sup>20</sup> These financial thresholds mean that only a very specific class of claim is considered for TPLF. TPLF provides no additional access to justice for claimants seeking non-monetary relief or in circumstances where aggregate claim thresholds are not met or where the prospective defendant does not meet Funders' criteria.

## QUALITATIVE CRITERIA FAVOUR A NARROW RANGE OF ACTIONS

If a claim is likely to be sufficiently valuable, Funders apply a range of qualitative criteria in order to determine the probability of a settlement or award. The application of these criteria has tended to further narrow the class of claims considered.

Figure 2: Claims Considered by Funders



IMF states that it will not consider claims which are likely to be dependent upon oral evidence, actions which will involve a factually-rich forensic inquiry or actions where proof of causation is likely to be problematic.<sup>21</sup> It has a stated preference for claims where it considers there is evidence that the conduct of the defendant is “*reprehensible*,”<sup>22</sup> and it is reluctant to take on cases which are likely to involve multiple defendants.<sup>23</sup>

The claims which are most likely to meet these criteria are those involving alleged breaches of market protection legislation, e.g., breaches of disclosure obligations, misleading or deceptive conduct, product liability or competition legislation.<sup>24</sup>

Within this range of actions, product liability claims and cartel claims pose further difficulties which render them unlikely to be funded. Funders have tended to regard product liability claims as risky because they often lack a sufficient degree of commonality between group members and frequently involve detailed factual evidence and additional claims against other non-party defendants.<sup>25</sup> Cartel actions are often considered unsuitable because of evidentiary difficulties arising from the secretive nature of cartels and a lack of regulatory co-operation, dispersal of class members and problems with loss quantification.<sup>26</sup>

As a result of applying these factors, Funders have displayed a strong bias towards funding large-scale securities class actions. Because of the complexity of securities actions, as well as the large sums involved, these cases have consumed significant court resources. Of the 18

funded class actions brought in the Federal Court up to 2009, 11 related to securities, one was a cartel proceeding and the remaining six concerned disparate issues.<sup>27</sup> Since 2010, at least a further nine funded securities class actions have been issued. In securities class actions, institutional investors with substantial claims generally constitute the bulk of group member claims by value. Institutional investors do not constitute a class of claimant which could not afford access to justice absent TPLF. The class action mechanism has been employed by institutional investors in a manner which allows recovery of claimed losses, while protecting institutional investors from both the scrutiny of their individual claims and the risk of adverse costs orders which they would bear if they were party to proceedings. While smaller investors have also participated in securities class actions, as discussed below, funded securities class actions are increasingly being run in a manner which favours institutional investors and which erodes or eradicates any access to justice benefits for those with smaller claims.

## Limited Participation in the Fruits of Class Actions

In order to generate a return on their investment, Funders must be confident that a substantial proportion of class members will contribute to their fees and uplifts.<sup>28</sup> This desire to maximise return on investment, and an associated concern with preventing ‘free riders’ from sharing in the fruits of funded litigation, have led to two trends which further limit access to justice: the rise of closed classes and a focus on actions involving larger class members such as institutional investors and sophisticated

corporate customers. Closed class proceedings can usefully address significant problems caused by opt-out proceedings such as quantification of claims and class member consent. They are discussed here because they run counter to the rationale that funding increases access to justice.

## FUNDERS PREFER CLOSED CLASSES

Funders have a strong incentive to ensure that as many group members as possible share the costs of class action proceedings. Broader participation in funding agreements increases the economic viability of actions and Funders' returns. It is undermined where class members are able to free ride by participating in the fruits of a class action without contributing to its costs.

In recent times, Funders have sought to prevent free riding by adopting closed classes. In a closed class case, the representative applicant defines the class to include only those who have entered into funding agreements with the Funder.<sup>29</sup> Closed class proceedings can be contrasted with open class proceedings in which all persons coming within the class definition are able to make claims to receive money from a fund which is established after settlement or judgment to distribute damages or settlement funds, irrespective of whether they have entered into a funding agreement. After some initial uncertainty,<sup>30</sup> the closed class mechanism has been found to be permissible by the courts.<sup>31</sup> Closed classes were adopted in 13 of the 18 funded class actions pursued in the Federal Court between 1992 and 2009.<sup>32</sup>

One side-effect of the employment of closed classes is the commencement of copycat class actions. Because a closed class, by its nature, is generally

limited to those who have entered into a funding agreement, there may be a sizeable rump of claimants who have not entered into a funding agreement but who otherwise meet the class definition of the initial action. In those circumstances, there is a substantial risk that a second action (whether open or closed) will be commenced soon after by a second law firm (with or without funding) seeking to piggyback off the first action. The *Centro*,<sup>33</sup> *Nufarm*<sup>34</sup> and *Oz Minerals*<sup>35</sup> class actions all saw the commencement of mirror proceedings of this kind. This phenomenon can result in substantial duplication of legal costs and has the potential to substantially undermine the goals of efficiency and certainty underlying the class action regime in Australia.

The extent to which access to justice is facilitated by closed classes appears limited, as the members of such classes often reflect a relatively small number of claimants (usually institutional investors) with relatively large claims. For example, in the *Multiplex* class action,<sup>36</sup> the closed class of around 100 members comprised a large number of institutional investors whose claims formed 99% of the claims in terms of dollar value.<sup>37</sup> In the *Centro* proceeding, the closed class represented by Maurice Blackburn contained 1,349 group members, while the open class represented by Slater & Gordon was estimated to contain in excess of 5,000 group members who were mostly "mums and dads and other small investors."<sup>38</sup> The relative size of the claims in the respective classes was borne out by the distribution of the settlement sums with \$150 million (before legal costs and the Funder's return) of the \$200 million settlement sum allocated to the closed class.

## CLASS ACTIONS ARE INCREASINGLY TAILORED TO INTERESTS OF LARGER, MORE SOPHISTICATED CLIENTS

Another trend in recent times has been the exclusion of smaller, 'mum and dad' claimants from class actions. Actions consisting of large numbers of smaller claimants (where access to justice concerns are presumably most acute), are often considered uneconomical to pursue and the incentives to pursue claims involving group members who have large claims such as institutional investors and corporate customers (where access to justice concerns are least acute) are far greater. Indeed, senior management of IMF has candidly admitted that IMF may disqualify cases that are "made up of too many small claims."<sup>39</sup> Funders have also been known to seek exclusion of smaller claimants who come within a broader group definition.<sup>40</sup> For example, in the *Air Cargo* class action,<sup>41</sup> the group definition is confined to those who purchased services costing \$20,000 or more. These trends are particularly concerning given that a key policy argument for funded group proceedings is that they allow smaller claimants, who would otherwise lack the financial resources or incentive to bring a claim, to participate in proceedings and vindicate their rights.

In a similar vein, settlement agreements in recent class actions disclose a trend towards differential funding contributions based on the economic power of the class member, with institutional class members negotiating preferential funding arrangements with Funders. For example, in a recent funded shareholder class action, the settlement agreement provided for higher funder contributions from those with a smaller number of shares and lower contributions from those with large parcels.<sup>42</sup> While it might be argued that administration expenses justify the differential charges, larger institutional investors could be expected to take a more active interest in the conduct of a case and are likely to possess far greater bargaining power vis-à-vis the Funder than a small investor. There is a real danger that such differential arrangements effectively amount to the cross-subsidisation of institutional investors' claims by smaller 'mum and dad' investors. This is antithetical to the original goals of the class action system, which is intended to protect and promote the interests of small claimants.

A 'hands off' approach to the regulation of TPLF has traditionally been justified on access to justice grounds. However, recent trends in case selection, class closure and class composition suggest that the additional access provided by TPLF is limited.

“ Recent trends in case selection, class closure and class composition suggest that the additional access provided by TPLF is limited. ”

# Litigation Increase: Funding Increases the Scale of Class Actions

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The availability of TPLF increases the scale and complexity of litigation and carries with it the risk that unmeritorious claims will be funded in the hope of achieving a quick settlement.

## Statistical Evidence Suggests That Funding Increases Litigation

A recent report by David Abrams and Daniel Chen suggests that TPLF increases the scale and complexity of litigation.<sup>43</sup> This finding is consistent with the following features of TPLF.

### FIRST, FUNDERS CONSISTENTLY CLAIM THAT THEY INCREASE ACCESS TO JUSTICE

An increase in litigation is a necessary corollary of acceptance of this claim. As discussed above, there is good reason to doubt the extent to which Funders do provide access to justice. However, to the extent that such access is provided by Funders, this necessarily entails generating more litigation. By reason of the large potential profits available to Funders and to plaintiff law firms, it is in their respective commercial interests to seek to foment litigation. In its 2013 Annual Report, Slater & Gordon, a publicly listed Australian law firm, openly states that one of its priorities for the current financial year is *"re-building the pipeline of funded class action matters."*<sup>44</sup>

### SECOND, THE VERY PRESENCE OF FUNDERS INCREASES THE COMPLEXITY OF LITIGATION

Once Funders are involved in litigation the following complexities often occur:

- **Access to Funding Agreements:** it has been common for interlocutory disputes to arise in relation to defendants' access to the funding agreement;<sup>45</sup>
- **Security for Costs:** applications for security for costs are more readily made when a Funder is involved;<sup>46</sup>
- **Judicial Oversight of Funding:** the propriety of the involvement of the Funder may itself require judicial consideration, such as whether the specific funding arrangements are an abuse of process<sup>47</sup> or create irreconcilable conflicts<sup>48</sup> for the solicitors on the record; and
- **Settlement Process:** the presence of Funders necessarily complicates the court's approval of settlement of class actions.

### THIRD, THE CONTINGENT NATURE OF FUNDERS' FEES CREATES AN INCENTIVE FOR THE FUNDER TO MAKE CLASS ACTIONS AS LARGE AS POSSIBLE

Obviously, large class actions take up more court time, potentially raise complex issues such as finding suitable representative claimants to represent all of the class and relating to causation and are inherently more difficult to case manage.

### FOURTH, THE QUANTUM OF SETTLEMENT FIGURES OF RECENT SECURITIES CLASS ACTIONS HAS BEEN INCREASING

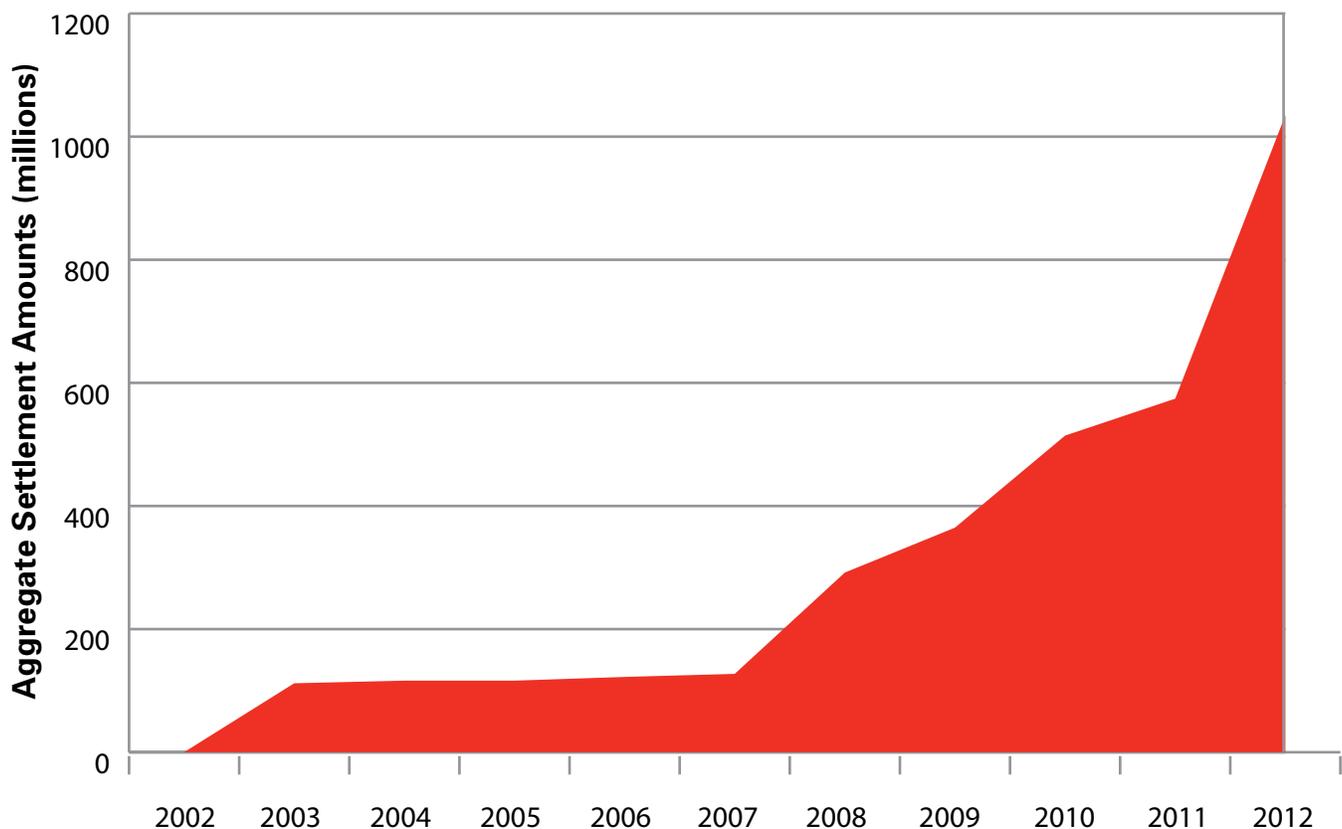
As shown in Figure 3 below, the scale of class actions is increasing with the majority of such actions being funded. This indicates that TPLF is increasing the scale of class actions.

It should not be assumed that the below figures represent the true value received by group member claimants. Significant portions of those settlement figures would have been directed towards legal costs and returns to Funders. For example, of the \$200 million for which the *Centro* class action settled,<sup>50</sup> \$62 million went to IMF and an unknown amount to the other Funder, Comprehensive Legal Funding LLC (CLF),<sup>51</sup> and a total of \$32 million in legal fees was approved by the Court.

### FIFTH, THERE IS NOTHING PREVENTING TWO OR MORE FUNDERS FUNDING COMPETING CLASS ACTIONS IN RESPECT OF THE SAME GRIEVANCE

This was the case in the *Centro* class action where IMF funded two actions, with Maurice Blackburn acting, and CLF

Figure 3: Significant securities class action settlements<sup>49</sup>



funded a third action against Centro, with Slater & Gordon acting. Other examples of competing funded class actions include proceedings relating to:

- **Oz Minerals:**<sup>52</sup> The two class actions, which involved Maurice Blackburn funded by IMF, and Slater & Gordon funded by Litigation Lending Services Limited (LLS), saw a total of just under \$5 million in legal fees awarded, with Funder IMF reporting a net gain of \$12.8 million from its investment in the proceedings<sup>53</sup> and more than \$2.8 million being paid to LLS.<sup>54</sup>
- **Nufarm:**<sup>55</sup> Two class actions were commenced in relation to continuous disclosure allegations, with Maurice Blackburn funded by International Litigation Funding Partners Pte Ltd (ILFP) and Slater & Gordon funded by CLF. The two proceedings were consolidated in mid-2011 on the basis of joint representation, and a settlement of \$46.6 million (inclusive of costs and Funders' fees) was approved in November 2012.

Such parallel funding of parallel class actions creates unnecessary duplication of costs, and adds a further level of complexity to the proceedings in general and in particular to attempts to settle such proceedings.

## Funding May Encourage Unmeritorious Claims

The Supreme Court of New Zealand recently commented that TPLF “*could exacerbate the risk of defendants being faced with unmeritorious claims and forced into unjustified settlements.*”<sup>56</sup> This echoes the sentiments expressed in 2009 by Justice Keane. His Honour noted that the case of *Emmanuel & Ors v Fosters*<sup>57</sup> was “*an exemplar of the concern that litigation funding does promote the pursuit of frivolous litigation.*”<sup>58</sup> In that case, Justice Chesterman indicated that “*there was a degree of irresponsibility in the plaintiffs’ bringing and prosecuting their actions,*” found that the proceedings were vexatious and ordered indemnity costs against the plaintiffs.<sup>59</sup>

This may be so because Funders are looking for a sufficient scale of claim which works for their business models. In relation to class actions, Funders are not necessarily concerned with scrutinising the merits of individual claims, and unmeritorious claims, which might not succeed if pursued individually, can be hidden within a large class.

# Conflicts of Interest: Inherent in Third Party Litigation Financing

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At the core of the relationship between lawyers and clients is lawyers' duty of undivided loyalty to their client: they must avoid conflicts between their personal interest and the interests of their client and thus must never gain unauthorised profit from their position. However, the nature of TPLF increases the risk that a lawyer's loyalty will be divided between the client and the Funder. To date, these risks have not been subject to effective oversight, despite the introduction of the Australian Securities and Investments Commission's (ASIC) conflict of interest regime in July 2013.

## Structural Risks

Both the contractual arrangements involved in TPLF and the long-term nature of the relationships between Funders and particular law firms heighten the risks of conflicts of interest arising for lawyers between the interests of Funders and the interests of their clients. This heightened risk is caused by at least three factors, commonly present in funded litigation.

### **FIRST, FUNDERS OFTEN ENJOY A LARGE DEGREE OF CONTROL OVER LITIGATION THEY CHOOSE TO FUND**

As the New South Wales Law Reform Commission explained:

To ensure the success of the litigation, the funder takes control of major decision making. This may include retaining and giving instructions to the solicitor who acts for the plaintiff, prohibiting that solicitor from directly liaising with the plaintiff, and reserving the right to settle the claim.<sup>60</sup>

In *Campbells Cash & Carry v Fostif*,<sup>61</sup> where the High Court held that TPLF was not an abuse of process, the Funder had almost complete control over the conduct of the litigation, save that it required 75% approval from the represented claimants before it could agree to a settlement. The solicitors were forbidden from contacting the claimants directly. Such an arrangement

clearly undermines the lawyer/client relationship, for it can hardly be said that such a lawyer has undivided loyalty to the clients when the lawyer is unable to contact them or to take instructions from them.<sup>62</sup> Where the Funder's interests conflict with those of the clients, the instructions given to the lawyers will clearly be in line with the Funder's interests.

That is not to say that Funders always enjoy this level of control in proceedings they fund.<sup>63</sup> However, without adequate regulation, Funders are free to contract for such control, which heightens the risk that instructions given to lawyers will be in conflict with the interests of clients.

### **SECOND, IT IS COMMON FOR FUNDERS AND PLAINTIFF LAW FIRMS TO DEVELOP CONTINUING RELATIONSHIPS, WHICH POTENTIALLY TEST LAWYERS' UNDIVIDED LOYALTY TO THEIR CLIENTS**

Many of those clients are only with the firm for the life of the action, whereas the relationship between the firm and the Funders spans over multiple actions and carries with it the promise of future collaboration and remuneration, as Funders often influence the selection of lawyers for claims they fund.<sup>64</sup> For example, it appears that the majority of class actions underway in the Federal Court since 2011 in which Maurice Blackburn has acted have been funded by IMF.<sup>65</sup>

There is a risk that the value of such a relationship to a law firm may (unconsciously) influence choices made by lawyers during proceedings, including when the interests of Funders and claimants collide. As Justice Keane said in relation to the High Court's decision to allow litigation funding:

I suppose we should be celebrating the good news that the pessimistic view of human nature which, for several hundred years, has informed the common law's disapproval of champerty is no longer correct. Lawyers used to be greedy, but now we're better. And to the extent that we lawyers might still be susceptible to distraction from our duty by our own pecuniary interests, it is comforting to be reminded that the courts can prevent abuse of their processes. But, in my respectful opinion, these sanguine expectations are not justified by experience.<sup>66</sup>

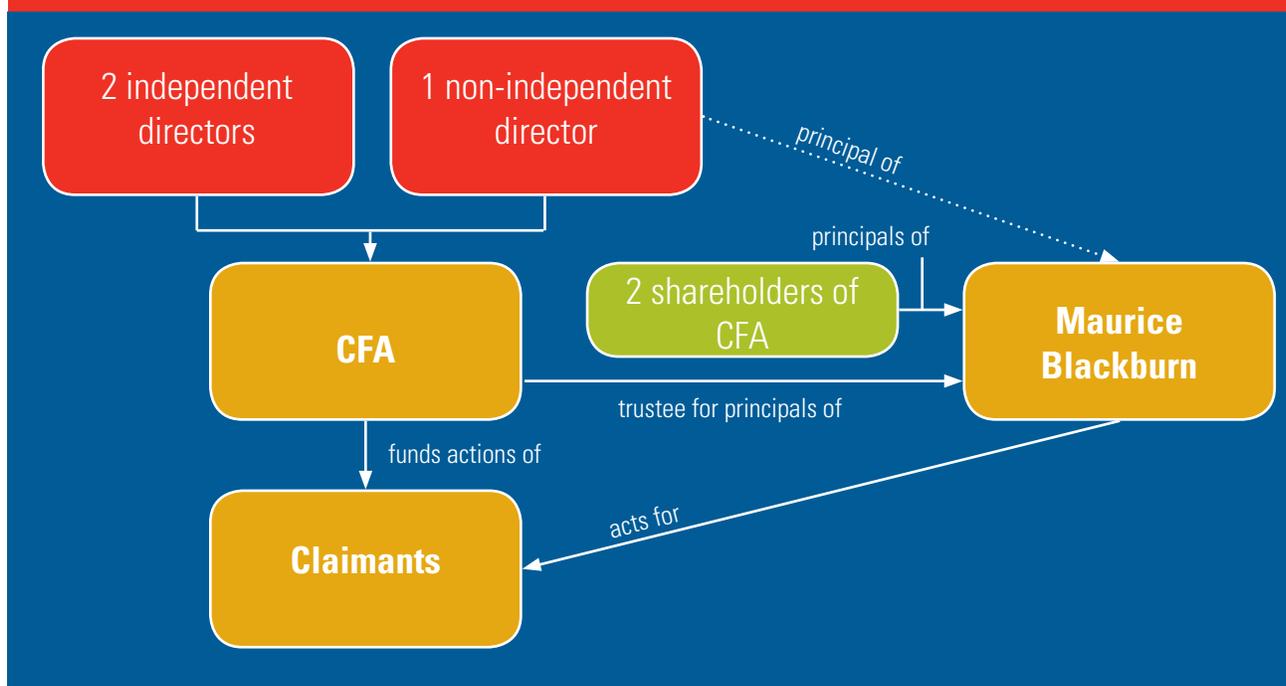
### **THIRD, ONCE A CLASS OF CLAIMANTS HAS BEEN AMASSED, IT IS COMMON FOR FUNDERS AND LAWYERS TO CHOOSE THE REPRESENTATIVE PLAINTIFF**

The representative plaintiff, unless prohibited from doing so by agreement with the Funder will instruct the lawyers. This enables Funders and lawyers to choose a compliant representative plaintiff who will not provide instructions that will conflict with the interests of the Funder, even when such instructions are not in the best interests of the representative plaintiff or the class as a whole.

### **A Worrying Development**

One plaintiff law firm, Maurice Blackburn, has established its own Funder, Claims Funding Australia Pty Ltd (CFA), which funds actions in which a principal of Maurice Blackburn is the solicitor on the record. The relationship between CFA and Maurice Blackburn, as it currently stands, is demonstrated in Figure 4.<sup>67</sup>

**Figure 4: Ownership / Control Structure of CFA**



This type of arrangement potentially:

- increases the risk of conflicts of interest between lawyers, Funders and claimants; and
- undermines the independence of lawyers from the Funder and the claimants.

The risks associated with conflicts of interest are heightened by the arrangement, such as the one outlined above, as the interests of the principals of the law firm and the Funder are more directly aligned. This is so because any profit made by the Funder is (despite the interpolation of a trust structure) effectively made on behalf of the principals of the law firm. If a conflict of interest arises between the claimants and the Funder, the principals of the law firm have a greater pecuniary

incentive to side with the Funder, given the Funder is acting in the principals' financial interest. This arrangement exacerbates the issues Justice Keane identified that: "[T]he vindication of victims' rights is the last thing on the mind of the funders and the lawyers whose interests they serve."<sup>68</sup>

“ [T]he vindication of victims' rights is the last thing on the mind of the funders and the lawyers whose interests they serve. ”

It is hard to see how a lawyer's loyalty to their client could be said to be 'undivided' where such an arrangement exists. This is not to say that principals of such firms will act improperly, only that the pecuniary alignment of the interests of Funders and lawyers increases the risk that they might do so.

Before signing a funding agreement with CFA, claimants are required to sign a declaration that they have considered obtaining independent legal advice in relation to the arrangement.<sup>69</sup> This requirement suggests a tacit acknowledgement of the problems the arrangement may create for claimants, such as conflicts of interest. Further, the requirement for claimants to pay for independent legal advice is difficult to reconcile with the Funders' purported role in providing access to justice for those who could not otherwise afford it.

The arrangement also has the potential to undermine the independence of principals of the law firm from both the Funder and the claimants. In *Waterford v the Commonwealth*,<sup>70</sup> Justice Brennan opined that a necessary component of being a legal adviser is a degree of independence from one's client. It could be said that such arrangements undermine the independence of law firms, as its principals would have 'too much skin in the game.'

## Regulation Fails To Adequately Address the Heightened Risk of Conflict

From 12 July 2013, litigation funding arrangements have been governed by the *Corporations Amendment Regulation 2012 (No. 6)* (Cth), as explained by ASIC's Regulatory Guide 248. This Regulation requires Funders to have written procedures including in relation to:

- identifying and evaluating potential conflicts of interest;
- disclosing conflicts of interests to members; and
- managing conflicts of interest in relation to settlement offers.

These regulations are a step in the right direction to manage the risks outlined above. However, no direct consequences flow from a failure to comply with the regulations. As ASIC's Regulatory Guide makes clear, breach of the regulation will only be met with exposure to greater risk of regulatory action.<sup>71</sup> Such regulatory action may include a Funder having to acquire an Australian financial services licence and comply with the provisions of the *Corporations Act 2001* which regulate managed investment schemes. The vague threat of such regulatory actions is insufficient to ensure that the heightened risks associated with TPLF are addressed. For the regulations to be effective, they require teeth.

# Open Class Actions: Prejudice to Non-Funded Group Members

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The past five years have seen a number of funded open class actions in which the representative applicant and some, but not all, group members enter into a funding agreement with a Funder (the funded group members) while the remaining group members do not enter into such an agreement and also do not opt out of the class action (the non-funded group members). The funded group members are contractually obliged to pay a percentage of any monies they recover to the Funder, whereas the non-funded group members are not.

Accordingly, if there is no differentiation between funded and non-funded group members in any settlement of the class action, the non-funded group members may stand to recover a greater proportion of their claimed losses as they are not obliged to pay a percentage of amounts they recover to a Funder.

This issue has been addressed in two ways in recent settlements. First, a number of settlements have used an 'equalisation factor' in calculating group member distributions.<sup>72</sup> An equalisation factor reduces the amount payable to non-funded group members and proportionally increases the amount payable to funded-

group members so that the burden of the Funder's premium is effectively shared by all group members irrespective of whether they are funded or non-funded. The employment of an equalisation factor 'equalises' the position of funded and non-funded group members so that they stand to recover the same proportion of their claimed loss, but does not increase the amount payable to the Funder. The second method which has been proposed in at least two settlements (one of which was approved,<sup>73</sup> one of which was rejected),<sup>74</sup> involves the Funder being paid their full premium by funded group members *and* being paid additional premium by non-funded group members, the result being

that the Funder would recover *more* than they are contractually entitled to.

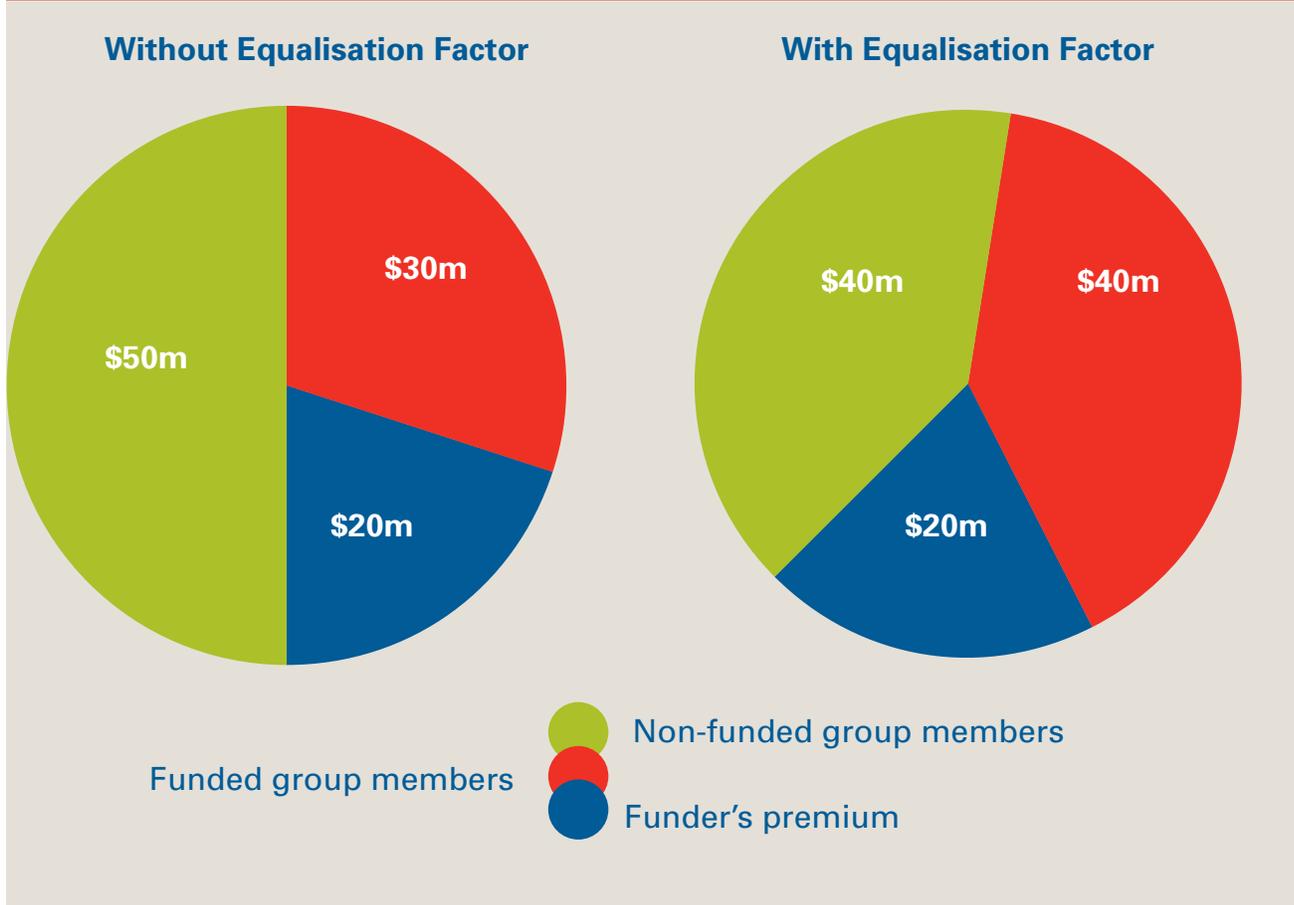
This section discusses settlements where these two mechanisms have been proposed and notes some of the issues to which they give rise, including:

- whether non-funded group members are adequately represented in the settlement of funded class actions;
- whether scrutiny should be given to the reasonableness of premiums extracted by Funders where an equalisation factor is proposed;
- the potential for conflicts of interest to arise between the interests of the representative applicant and funded group members, on the one hand, and the interests of non-funded group members, on the other; and
- the potential for abuse of class action settlements by Funders in order to extract a return beyond that to which they are legally entitled.

## What is an Equalisation Factor?

A number of recent class action settlements have adopted equalisation factors. While these may differ in form, they should theoretically have the same mathematical effect. To take a simplified example, suppose there is a class action with 50 funded group members and 50 non-funded group members all with claims of equal value and strength, except that the 50 funded group members are contractually obliged to pay 40% of any individual net recoveries to their Funder. Suppose further that the class action settles and there is a sum of \$100 million available for distribution to group members. If all group members are treated on the same basis in the settlement, each group member would recover \$1 million, but each funded group member would be left with only \$600,000 in hand after paying the 40% premium to their Funder. In the end, the 50 non-funded group members would receive \$50 million, the 50 funded group members would receive \$30 million and the Funder would receive the remaining \$20 million. A typical equalisation factor will alter this situation so that the Funder continues to receive \$20 million, but each group member (whether funded or non-funded) is left with \$800,000 in hand after the funded group members' liabilities to the Funder are discharged.

**Figure 5: Settlement Distribution With and Without Equalisation Factor**



## Is There Justification For An Equalisation Factor?

While the practice of employing equalisation factors has developed without extensive court scrutiny, there has been some passing discussion of their rationale. In approving the settlement of the *Aristocrat* class action,<sup>75</sup> Justice Stone noted:

The difference in the amounts allocated to funded and non-funded group members is explained by the fact that the funded group members have undertaken liability

for costs of the action through the litigation funder.<sup>76</sup>

In the *Multiplex* class action, Justice Finkelstein accepted a submission that:

fairness to the funded class members, without whom the proceedings could not have continued, requires that the non-funded group members are in no better position for having been unfunded for a matter of weeks prior to the in-principal settlement having been reached.<sup>77</sup>

Finally, in the *GPT* class action,<sup>78</sup> Justice Gordon herself proposed an equalisation factor (having rejected the proposed ‘extra premium’ scheme discussed below) which was said to be necessary to avoid the non-funded group members receiving a “windfall.”<sup>79</sup>

These arguments in favour of equalisation factors are redolent of those justifying the so-called common fund doctrine. Put broadly, the doctrine states that to allow non-parties to benefit from the plaintiff’s efforts in pursuing litigation without contributing to the expenses of that litigation would allow the non-parties to be enriched unjustly at the plaintiff’s expense. In the present context, the commitment by funded group members to pay premium to a Funder appears to have been treated by courts as a cost incurred in bringing the settlement fund into existence, and it is therefore said to be unfair for a non-funded group member to be able to claim from that fund without bearing its proportion of the costs incurred. A number of things may be said in response to this assertion.

### **FIRST, ‘COMMON FUND’ REASONING ONLY EXTENDS TO COSTS WHICH ARE REASONABLE AND WHICH ARE NECESSARY IN BRINGING ABOUT THE EXISTENCE OF THE FUND**

If funded group members have agreed to pay an exorbitant or uncommercial level of premium, there is no reason why they should be entitled to recover those amounts from the settlement fund thereby diminishing the returns available to non-funded group members. As the Australian Law Reform Commission noted when discussing the common fund doctrine in the context of lawyers’ fees:

[A]ny commitment of part of the monetary relief recovered by group members to costs must be subject to appropriate regulation by the court to protect the group member.<sup>80</sup>

Given that the practice of including equalisation factors in settlements has developed in the absence of an express statutory basis and with little consideration of its fairness by the courts, it is not clear that any form of effective regulation exists to protect the interests of non-funded group members. If the practice is to be effectively regulated, the reasonableness of the premiums charged by Funders may need to be considered by the courts.

### **SECOND, WHILE A REPRESENTATIVE APPLICANT MAY HAVE A GENUINE CLAIM TO THE REIMBURSEMENT OF REASONABLE EXPENSES INCURRED IN PURSUING A CLASS ACTION TO SETTLEMENT, SUCH A CLAIM IS HARDER TO JUSTIFY ON BEHALF OF A FUNDED GROUP MEMBER**

A funded group member is not a party to the proceeding and does not have conduct of it. Instead, they are simply a person who has made a voluntary commercial decision to enter into a private legal arrangement with a Funder. The rationale for allowing funded group members to defray the costs of that voluntary commercial decision at the expense of non-funded group members has not been adequately explained.

**THIRD, IT IS ALWAYS OPEN TO A REPRESENTATIVE APPLICANT TO COMMENCE A CLOSED CLASS PROCEEDING, LIMITED TO THOSE WHO HAVE ENTERED INTO FUNDING AGREEMENTS, IF THEY ARE CONCERNED THAT NON-FUNDED GROUP MEMBERS WOULD GET A FREE RIDE IN AN OPEN CLASS PROCEEDING**

A representative applicant who commences an open class proceeding and thereby agrees to represent the interests of funded and non-funded group members alike does so voluntarily and there is no reason why they should expect to be partially indemnified in respect of their private contractual obligations as a result (at least absent proper court scrutiny).

**Conflicts of Interest Between Funded and Non-Funded Group Members in Open Class Proceedings**

In representative proceedings, courts play a protective role and should be zealous to ensure that group members are not prejudiced by the conduct of litigation on their behalf. Ordinarily, a court in a class

action can rely “on the congruence of [group members’] interests with those of the representatives as the incentive for effective representation” because “the self-interest of the representative... drives the active party.”<sup>81</sup> That is not the case where a court is asked to consider the implementation of an equalisation factor. The representative applicant (whose lawyers will usually represent most or all of the funded group members) has a direct pecuniary interest in an equalisation factor being implemented as it will increase the distribution to which they (and all funded group members) are entitled. That interest is in direct conflict with the interests of non-funded group members, whose potential distributions are diminished in direct proportion to the increases received by funded group members.

It is true that a non-funded group member would be technically entitled to challenge the approval of an equalisation factor on the basis that it was neither fair nor reasonable. However, the ability of a group member to do so in practice is likely to be limited by a number of factors.

**FIRST, THE DEGREE OF NOTICE THAT HAS BEEN GIVEN TO GROUP MEMBERS OF PROPOSED EQUALISATION FACTORS HAS BEEN LIMITED AT BEST**

It is not possible to determine precisely how many settlements involving equalisation factors have been approved for this reason. Three examples of the degree of notice given of equalisation factors are given below.

**SECOND, NON-FUNDED GROUP MEMBERS OFTEN LACK THE RESOURCES AND INCENTIVES NECESSARY TO SCRUTINISE OR CHALLENGE A SETTLEMENT**

It is unrealistic to expect that unsophisticated group members with small claims could mount an effective court challenge to proposed discriminatory treatment, even if given proper notice, as it will usually not be economically feasible for them to do so. To our knowledge, there is no case in which a court has questioned the propriety of an equalisation factor or where a court has scrutinised

| AWB class action <sup>82</sup>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | Fuel surcharges class action <sup>83</sup>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | Aristocrat class action <sup>84</sup>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>The Notice of Proposed Settlement made no mention of the fact that an equalisation factor was proposed. Instead, a non-funded group member would need to have requested and understood a confidential and complex Loss Assessment Formula in order to discover that it was proposed that they would be treated on a different basis from funded group members in the settlement. No judgment was published in relation to the approval of that settlement, and it is unclear whether the fairness or reasonableness of the equalisation factor was an issue considered by the Court.</p> | <p>The Notice of Proposed Settlement referred to the fact that the Funder’s premium would be paid from the settlement amount and used the phrase ‘equalisation payment,’ but did not clearly explain what the ‘equalisation payment’ involved and, in fact, used that phrase in a manner which was confusing and internally inconsistent within the notice. Again, no judgment was published in relation to the approval of that settlement, and it is unclear whether the fairness or reasonableness of the equalisation factor was an issue considered by the Court.</p> | <p>The Notice of Proposed Settlement stated that there would be \$109 million available for distribution to funded group members and \$27 million available for distribution to non-funded group members, however the method by which those sums were calculated was not explained. There was no explanation that this would lead to the non-funded group members recovering a lesser proportion of their claimed losses than funded group members, nor was it stated that non-funded group members were effectively being asked to subsidise the premium owed by funded group members.</p> |

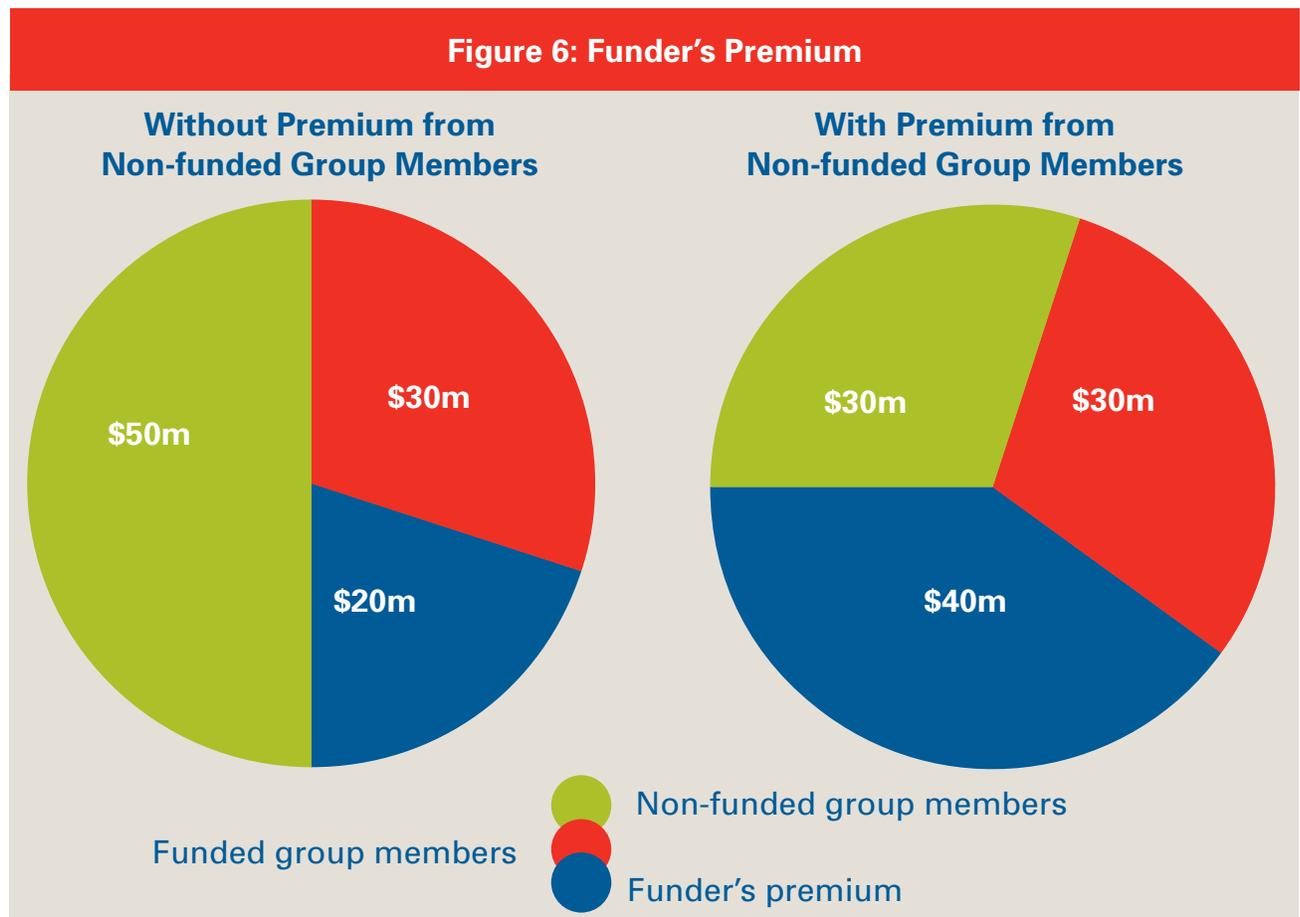
whether the premium paid to a Funder was a cost reasonably necessary to be incurred. For the reasons given above, it may be appropriate that a greater degree of scrutiny be applied in the future.

### Funders Seeking Premium in Excess of Contractual Entitlements

In both the class action brought by Pathway Investments Pty Ltd against National Australia Bank Limited (NAB)<sup>85</sup> and the class action brought by Modtech Engineering Pty Ltd against GPT Management Holdings Ltd (GPT),<sup>86</sup> a settlement was proposed which would have involved payments being made to a Funder not just in respect of recoveries by funded group members, but also in respect of recoveries by non-funded group members. Those proposed schemes

would have seen the Funder recovering a greater amount than that to which they were contractually entitled. The scheme was approved in the *NAB* class action but rejected in the *GPT* class action.

To re-work the example given above of the \$100 million settlement with 50 funded group members and 50 non-funded group members, such a mechanism would see the Funder recovering their 40% premium not only from the recoveries of the 50 funded group members, but also from the recoveries of the 50 non-funded group members. The result would be that the Funder recovers \$40 million rather than the \$20 million to which it is contractually entitled, with \$30 million left for the 50 funded group-members and \$30 million left for the 50 non-funded group members.



**NAB CLASS ACTION**

The action against NAB was originally commenced as a closed class proceeding, with the class limited to those who had entered into a funding agreement with ILFP. In order to facilitate settlement, orders were sought and made by consent of the parties to the proceeding which had the effect of “opening” the class to include those who had not entered into funding agreements with ILFP but who otherwise met the group definition. Those new group members could either register to participate in any settlement or opt out of the proceeding or do nothing (in which case they would have no entitlement to any recovery). However, the consent orders also provided that those group members who registered would become obliged to pay a premium to ILFP, with whom they had no pre-existing contractual relationship. The orders made by the Court incorporated detailed terms of the kind normally found in a funding agreement, stating:

Upon Resolution, each Registered Group Member will pay to the Funder or its nominee, from the Resolution Sum... [a]n amount equal to a percentage of the Net Resolution Sum where that percentage is determined by reference to the number of NAB shares purchased by the Registered Group Member in the period covered by the claims as follows:

| <b>Number of NAB Shares</b>               | <b>Percentage of Net Resolution Sum</b> |
|-------------------------------------------|-----------------------------------------|
| Less than 1 million                       | 40%                                     |
| Between 1 million and million (inclusive) | 35%                                     |
| More than 10 million                      | 30%                                     |

The Court did not publish its reasons for requiring in the consent orders that registered group members pay a commission to ILFP. It is unclear whether any consideration was given to the appropriateness or otherwise of employing the coercive powers of the Court in a fashion which effectively constructs a funding agreement between a group member and a Funder as a condition of that group member participating in any settlement. In its reasons for approving the settlement itself, the Court did discuss the effect of the consent orders, stating:

The original group members had each entered into agreements with the litigation funder agreeing to pay to the litigation funder a certain percentage of any distribution by reference to the number of the bank shares which they held... One of the [consent orders] provided for payments of comparable amounts by the registered group members (as defined). Group members potentially affected by this order have been on notice of its terms and none has objected. It is not for the Court to express a view about the commercial desirability of the quantum paid to the litigation funder under these arrangements, and there is no reason shown to withhold approval of the settlement because of the proportion of the settlement amount to be received by the litigation funder rather than by the group members themselves. In other cases it might be necessary for separate justification of the amounts paid to a litigation funder before the Court approves a settlement but that does not appear necessary in this instance. The amounts payable from the distribution to the original group

members appear to have been agreed to between sophisticated parties with substantial means and neither they, nor the registered group members, have raised objection.<sup>87</sup>

While it may be true that no group member objected to the order that registered group members pay commission, it is not apparent that group members were actually notified of the fact that they had a right to object. The consent orders had already been made at the time notice of the settlement was given and the effect of those orders was not dependent upon approval of the settlement. It is therefore not clear whether any of the new group members in the opened class would have been in a position to object to those orders. The Court's reluctance to enquire into the "*commercial desirability*" of the contractual relationships between ILFP and funded group members is an entirely understandable and proper reflection of those parties' freedom to contract as private parties. It is less clear, however, that a court should display similar reluctance in circumstances where it is asked to use its powers to impose a funding agreement upon non-funded group members as a condition of participating in any settlement.

These are issues with which the Court was asked to grapple in the absence of any clear statutory framework and without the benefit of argument between opposing voices. The statement by the Court that separate justification of payments to a Funder might be required in other cases suggests that these issues may demand greater consideration in the future.

## **GPT CLASS ACTION**

The *GPT* class action was also commenced as a "closed" class, but was subsequently opened by an amendment to the group definition. Unlike the *NAB* class action, no Court order at the time that the class was opened required group members who registered to pay a premium to a Funder, nor was any notice given of such a proposal to group members at the time they were asked to register. Nevertheless, when settlement was reached, it was proposed that commission should be paid to CLF in respect of settlement amounts allocated to the non-funded group members. Justice Gordon rejected the proposal, stating:

The deduction of the funding commission was never part of a commercial bargain reached by CLF with these [non-funded group members]. In fact, for whatever reason, the [non-funded group members] decided to do the direct opposite and not enter into a LFA [litigation funding agreement]. What has changed? I can identify no reason why the LFA should now be imposed on the [non-funded group members]. They have not agreed to it.<sup>88</sup>

Instead, Justice Gordon suggested and approved the implementation of an equalisation factor of the kind discussed above.

The scheme originally proposed in the *GPT* class action would have delivered to CLF an amount greater than that to which it was contractually entitled at the expense of all group members. The fact that this was proposed at all suggests the potential for exploitation of the settlement process by Funders. It begs the question of why the

representative applicant or their lawyers agreed to such a scheme and whether they were able adequately and independently to represent the interests of funded and non-funded group members alike.

## **COMMERCIAL INCENTIVES OF FUNDED GROUP MEMBERS AND FUNDERS**

The development of the two mechanisms discussed above reflects the pursuit of commercial self-interest by funded group members and Funders respectively, at the expense of non-funded group members:

- funded group members use equalisation factors to shift the burden of the premium they owe onto non-funded group members; and
- Funders have sought to maximise the amount of premium they are able to extract from group members by seeking premium over and above their contractual entitlements.

In the absence of any regulation of the conduct of funded class actions, the only check on such behaviour is the scrutiny of the Court on an approval hearing. There are powerful reasons to doubt that a funded representative applicant (or their lawyers) can adequately represent the interests of non-funded group members in a settlement hearing where a mechanism which discriminates against the interests of non-funded group members is proposed. In the absence of adequate representation, it would be unrealistic to suggest that courts can reliably identify and scrutinise all prejudicial treatment of non-funded group members.

As noted above, the level of notice given of these discriminatory mechanisms to non-funded group members has been limited at best and, even if adequate notice had been given, it is rarely the case that non-funded group members have the resources necessary to challenge such settlements. This is borne out by the recent experience in the class action commenced against Macquarie Bank Ltd arising from the collapse of Storm Financial.<sup>90</sup> That action was funded, not by a Funder, but by a subset of group members. The settlement proposed by the representative applicant, and approved at first instance, would have seen those group members who had contributed funds receiving substantially greater returns than those who had not. It was only because of the intervention of ASIC that this settlement was overturned on appeal as being neither fair nor reasonable.<sup>91</sup>

ASIC's intervention was a rare example where the approval of a class action settlement involved a genuinely contested hearing and one of very few cases in which a proposed settlement has been rejected. Several of the issues successfully raised by ASIC in opposing the settlement of the Storm proceeding (such as adequacy of notice to group members, absence of justification for differential treatment, and disproportionate return on investment) could quite properly have been raised in opposition to the equalisation and extra premium mechanisms approved in the Funder-driven class actions described above.

## PROTECTION OF NON-FUNDED GROUP MEMBERS

The treatment of non-funded group members in recent class action settlements gives rise to real concerns that their interests are being prejudiced without proper representation or consideration. Any response to these concerns must address three interrelated issues:

- the potential conflict of interest between the interests of Funders, funded group members and non-funded group members;
- the degree and quality of notice given to group members of proposed discriminatory mechanisms; and
- the adequacy of representation of non-funded group members where court approval is sought of such mechanisms.

At the very least, group members must be given clear notice of any proposed discriminatory treatment in class action settlements. Where there is a real conflict between the interests of the representative applicant and the interests of non-funded group members, it may also be appropriate to consider whether non-funded group members require independent representation (e.g. by a sub-group representative or an amicus curiae) and whether, in particular cases, the cost of that representation ought be borne by the Funder or by funded group members. Finally, any regulation of or restrictions to the ability of Funders to exert control over the conduct of proceedings may diminish the risk that Funders will seek to exploit class action processes in order to extract returns in excess of their contractual entitlements.

# Conclusion

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TPLF presents a number of challenges to the administration to justice in Australia, including:

## Increased Litigation

Statistical evidence indicates that TPLF increases the scale and complexity of litigation. This evidence accords with the examples of the impact TPLF has on litigation, including an increase in interlocutory disputes and the potential for parallel funding of parallel class actions. Furthermore, TPLF potentially increases the number of unmeritorious claims instituted as Funders are primarily concerned with class actions having sufficient scale, rather than the merits of individual claims.

## Conflicts of Interest

The structure of TPLF heightens the risks of conflicts of interests arising and influencing the actions taken by lawyers. This is so because Funders are free to contract for almost exclusive control of litigation they fund, and the long term nature of relationships between Funders and law firms discourages lawyers from making decisions adverse to the interests of Funders, even if those decisions are in the best interests of clients. The establishment of Funders by law firms may further increase these risks.

## Prejudice to Non-Funded Group Members

There is real reason for concern that the interests of non-funded group members are not being adequately represented or considered in the assessment of proposed settlements of funded class actions. The increasing use of equalisation factors and the cases in which additional premium has been sought by Funders highlight the conflict between the commercial incentives of funded group members and Funders, on the one hand, and the interests of non-funded group members, on the other. If non-funded group members are to be required to pay (whether directly or indirectly) commission to Funders, the reasonableness of that commission should be subject to court scrutiny and the interests of non-funded group members may require independent representation and consideration. At the very least, far greater notice of proposed discrimination between funded and non-funded group members should be required.

The mantra of Funders is that they provide increased access to justice. This is said to justify both the role played by Funders and the limited oversight that applies to them. However, the reality of TPLF is that cases

are chosen and run to maximise Funders' profits (which are substantial), and the extent to which TPLF provides access to justice for those who could not otherwise afford it is considerably overstated. Recent trends in case selection, class closure and class composition suggest that the additional access provided by TPLF is limited at best, and may not be justified by the attendant problems and risks which TPLF poses.

The issues discussed in this paper have arisen in the absence of meaningful government oversight of TPLF. In the case of class actions, the regime contained in the *Federal Court Act 1976* was developed when TPLF was prohibited. As a result, there is no legislative framework addressing a number of key issues, and courts have been asked to develop ad hoc and piecemeal solutions without any input from a number of affected stakeholders and with limited perspective on the systemic ramifications of those decisions. Given the unregulated and relatively young nature of TPLF in Australia, it is likely that further issues will emerge in the future.

These may include:

- what happens if a Funder collapses or walks away during the course of a class action;
- how the problem of competing class actions (with competing Funders and competing law firms) will be addressed; and
- whether Funders owe (or should owe) duties to both funded and non-funded group members.

Without a clear regulatory or legislative framework it is difficult to see how these issues will be resolved. Any programme of oversight should not only address existing issues with TPLF, but should anticipate those that may naturally occur as the practice of TPLF continues to gain an even stronger foothold in the civil justice system.

# Endnotes

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- 1 Justice Ronald Sackville, Speech delivered to the Class Actions Think Tank, 16 August 2012, as reported in Andrew Jennings, "Slice of the action", *Lawyers Weekly*, 4 December 2012, available at <http://www.lawyersweekly.com.au/features/slice-of-the-action>.
- 2 Explanatory Statement, *Corporations Amendment Regulation 2012 (No. 6)* - F2012L01549, available at <http://www.comlaw.gov.au/Details/F2012L01549/Explanatory%20Statement/Text>.
- 3 Chris Merritt, "Rising player sees danger ahead", *The Australian*, 24 May 2013, available at <http://www.theaustralian.com.au/business/legal-affairs/rising-player-sees-danger-ahead/story-e6frg97x-1226649540693>.
- 4 Wayne Attrill, "The Future of Litigation Funding in Australia" in Michael Legg, *The Future of Dispute Resolution* (LexisNexis Butterworths, 1st ed, 2013) 167 at 169.
- 5 Including IMF (Australia) Limited, Hillcrest Litigation Services Limited, LCM Litigation Fund Pty Limited, Litigation Lending Services Limited (specialising in insolvency actions) and Quantum Funding Pty Ltd (family law claims) – smaller Australian entities; and overseas based Comprehensive Legal Funding LLC (US), International Litigation Funding Partners Pte Limited (Singapore) and Omni Bridgeway (The Netherlands). In March 2012, UK-based Funder Argentum Investment Management Ltd (with its UK and Australian operational subsidiary Argentum Litigation Services Limited) also entered the Australian market as, recently, has Claims Funding Australia Pty Ltd, associated with plaintiff law firm, Maurice Blackburn Lawyers. 2117980 Ontario Inc, a company incorporated in the Province of Ontario, Canada, was initially the funder of the *Multiplex* class action (*P Dawson Nominees Pty Ltd v Brookfield Multiplex Limited & Anor* (Federal Court proceeding VID 1380 of 2006)) before its interest was assigned to International Litigation Funding Partners Pte Ltd (see *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* [2008] FCA 1769 at [1]). It no longer appears to be operating in the Australian market.
- 6 Michael Legg, "Litigation Funding in Australia Identifying and Addressing Conflicts of Interest for Lawyers", *US Chamber Institute for Legal Reform*, 2012 at 4.
- 7 IMF website, available at <http://www.imf.com.au/funding.asp>.
- 8 In April 2013, IMF announced that, as a result of changes to the *Corporations Act 2001* (Cth), which exempt litigation funding schemes and arrangements from requiring an AFSL, IMF applied to the Australian Securities and Investments Commission to have its AFSL cancelled. IMF stated that ASIC granted the cancellation on 18 April 2013, but that it remained of the view that litigation funders operating in Australia should be licensed and that IMF will re-apply for an AFSL should it be able to do so in the future: IMF website, available at [http://www.imf.com.au/docs/default-source/site-documents/c46275e6-6eb3-467b-9aa6-82a5ed288917-\\_australian-financial-services-licence--19-apr-13](http://www.imf.com.au/docs/default-source/site-documents/c46275e6-6eb3-467b-9aa6-82a5ed288917-_australian-financial-services-licence--19-apr-13).
- 9 Hillcrest Litigation Services Limited's website, available at <http://www.hillcrestlitigation.com.au/profile/litigation-in-australia/>.
- 10 LCM Litigation Fund Pty Ltd website, available at <http://www.lcmlitigation.com.au/>.
- 11 Wayne Attrill, "The Future of Litigation Funding in Australia" in Michael Legg (ed), *The Future of Dispute Resolution* (LexisNexis Butterworths, 1st ed, 2013) 167 at 179.
- 12 The Hon Chris Bowen MP, "Government Acts to Ensure Access to Justice for Class Action Members" (Speech delivered at the Shareholder Class Action Conference, Sydney, 4 May 2010).
- 13 See, for example, Justice Keane, "Access to Justice and Other Shibboleths" (Speech delivered at the Judicial Conference of Australia Colloquium, Melbourne, 10 October 2009); Justice Sackville, Speech delivered to the Class Actions Think Tank, 16 August 2012; Justice McDougall, "Keynote Address" (Speech delivered at the New South Wales Young Lawyers' Civil Litigation Seminar, Sydney, 13 March 2010) at [36]; *Godfrey Waterhouse & Ors v Contractors Bonding Limited* [2013] NZSC 89 at [41].
- 14 Justice Ronald Sackville, Speech delivered to the Class Actions Think Tank, 16 August 2012, as reported in Andrew Jennings, "Slice of the action", *Lawyers Weekly*, 4 December 2012, available at <http://www.lawyersweekly.com.au/features/slice-of-the-action>.

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- 54 The settlement of the two proceedings was jointly approved in July 2011: *Hobbs Anderson Investments Pty Limited v OZ Minerals Limited* [2011] FCA 801; see also *Scott v OZ Minerals* [2013] FCA 182.
- 55 *Gaby Hadchiti & Ors v Nufarm Ltd* (Federal Court proceeding NSD 1847 of 2010).
- 56 *Godfrey Waterhouse & Ors v Contractors Bonding Limited* [2013] NZSC 89 at [42].
- 57 *Emmanuel Management Pty Ltd (In Liq) v Foster's Brewing Group Ltd* (2003) 178 FLR 1.
- 58 Justice Keane, "Access to Justice and Other Shibboleths" (Speech delivered at the Judicial Conference of Australia Colloquium, Melbourne, 10 October 2009) at 8; see too *Godfrey Waterhouse & Ors v Contractors Bonding Limited* [2013] NZSC 89 at [42].
- 59 *Emmanuel Management Pty Ltd (in liquidation) & Ors v Foster's Brewing Group Ltd & Ors and Coopers & Lybrand & Ors* [2003] QSC 299 at [19]–[31].
- 60 NSW Law Reform Commission, "Security for Costs and Associated Costs orders" (December 2012) at [3.3].
- 61 *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386.
- 62 See too: LCM Litigation Fund Pty Limited, "Litigation Funding & Management Agreement", available at <https://clientportal.piperalderman.com.au/whitesands/LCM%20Funding%20Agreement.pdf>, which forbids a group member from having any communications in regard to settlement with any defendant, including through any solicitors retained in the matter, without the prior written agreement of the Funder.
- 63 See, for example, the Litigation Lending Services Limited agreement, available at [http://www.litigationlending.com.au/public/download/Funding\\_Agreement.pdf](http://www.litigationlending.com.au/public/download/Funding_Agreement.pdf), which allows plaintiffs to instruct the solicitors.
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- 67 Alex Boxsell, "Law firm bankrolls litigation funder", *Australian Financial Review*, 19 April 2013; Alex Boxsell, "Judge probes lawyers' horse flu damages case", *Australian Financial Review*, 26 July 2013; *The application of Claims Funding Australia as Trustee for the Claims Funding Australia Trust* (Federal Court proceeding NSD 630 of 2013).
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- 70 *Waterford v The Commonwealth* (1987) 163 CLR 54 at 70.
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- 74 *Modtech Engineering Pty Limited v GPT Management Holdings Limited* [2013] FCA 626.
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- 76 *Dorajay Pty Ltd v Aristocrat Leisure Ltd* [2009] FCA 19 at [17].
- 77 *P Dawson Nominees Pty Ltd v Brookfield Multiplex Ltd (No 4)* [2010] FCA 1029 at [28].
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