

LITIGATION FUNDING

PRESENTATION TO THE AILA NATIONAL CONFERENCE

1. Introduction

Litigation funding in Australia (other than by solicitors providing legal services on a “no win, no fee” pricing policy) emanated from the insolvency market and was enabled by the Corporations Act and Bankruptcy Act providing external controllers and trustees in bankruptcy with statutory powers of sale. Since the commencement of insolvency regimes in Australia, insolvency practitioners have exercised their statutory powers of sale to sell a portion of the fruits of their actions in return for funding to conduct the litigation (the “Insolvency Market”). This was seen as an exception to the rules against maintenance and champerty as the Courts would not prohibit that which the legislature permitted.

Accordingly, from 1997 to 2001, IMF’s business and the business of its predecessor was limited to funding insolvency practitioners.

In 2001, IMF listed on the Australian Stock Exchange and broadened its funding to also include:

- (a) non insolvency related commercial litigation conducted solely in the Supreme Courts and Federal Court with claim values over \$2 million (“Commercial Litigation”); and
- (b) multi party commercial claims usually involving breaches of the Corporations Act and Trade Practices Act (“Group Actions”).

This decision was based upon a belief that considerations of public policy that once found maintenance and champerty repugnant would focus more in the future on the social utility of litigation funding.

After addressing the infinitely more liberal attitude towards litigation funding shown by the Courts over the last 20 years, President Mason in the NSW Court of Appeal in *Fostif Pty Ltd v Campbells Cash and Carry Pty Ltd* [2005] NSWCA 83 at paragraph 100 said:

“These changes in attitude to funders have been influenced by concerns about access to justice and heightened awareness of the cost of litigation. Governments have promoted the legislative changes in response to spiralling costs of legal aid. Courts have recognised these trends and the matters driving them. “Ambulance chasing” still has negative connotations in many quarters, but it is now widely recognised that there are some types of claim that will simply never get off the ground unless traditional attitudes are modified.”

Currently, there are about four or five other litigation funders in Australia providing funding broadly on the basis that the funder agrees to pay the legal costs associated with the claim and agrees to pay the defendant’s costs in the event the claim fails in return for a share of the proceeds of any settlement or judgment, if any.

2. Types of Causes of Action Funded

Third party litigation funding will not assist in providing access to justice for the vast majority of civil actions currently before the Courts.

As far as I am aware, funding is limited to Commercial Litigation principally in the Supreme and Federal Courts in each State of Australia.

Personal injury claims, workers compensation claims and other causes of action for which risks may be statistically predicted with sufficient accuracy across many cases (“Insurable Risk Cases”) are funded by solicitors utilising a “no win, no fee” pricing policy. This risk assumption by solicitors in respect of Insurable Risk Cases is acceptable to them due to the low risk profile of the actions across a portfolio of cases.

Insurable Risk Cases also make up the vast majority of cases obtaining After The Event insurance in the United Kingdom litigation funding market discussed below.

IMF’s investment protocol until 2001 did not include a minimum size restriction. This created outcomes too often involving the majority of the settlement or judgment sum in small claims going in legal costs, insolvency practitioner fees and IMF’s fee.

As a result of this experience, when it listed in 2001, IMF included a minimum claim size in IMF’s Investment Protocol of \$2 million in acknowledgement of the fact that the cost of Commercial Litigation together with the associated risks, made funding small claims commercially unviable. Most of the other litigation funders will invest in the smaller claims, although the funded parties in these cases will always run up against a high cost/benefit ratio.

An exception to the minimum \$2 million claim value is where a large number of claims can be grouped together and prosecuted in a Group Action.

Where this can be achieved, claims each of less than \$10,000 in value can be processed economically, returning funded parties about \$7,000. This outcome was achieved for about 8000 IMF funded parties in a Group Action against British and American Tobacco and Phillip Morris in 2003.

Accordingly, I consider litigation funding in Australia in the short to medium term will predominantly be limited to Commercial Litigation involving high claim values and Group Actions.

3. The Demand for Litigation Funding

People determining whether to commence Commercial Litigation or Group Actions in Australia are usually confronted with the same risks Lord Woolf identified in 1996 when he examined the English and Welsh civil justice system and remarked:

*“The defects I identified in our present system were that it is too expensive and that the costs often exceed the value of the claim; too slow in bringing cases to a conclusion and too unequal; there is a lack of equity between the powerful, wealthy litigant and the under-resourced litigant. It is too uncertain: the difficulty of forecasting what litigation will cost and how long it will last induces the fear of the unknown; and it is incomprehensible to many litigants. Above all it is too fragmented in the way it is organised since there is no one with clear overall responsibility for the administration of civil justice; and too adversarial as cases are run by the parties, not by the courts and the rules of the court, all too often, are ignored by the parties and not enforced by the court.” (Lord Woolf, *Access to Justice: Final Report to the Lord Chancellor on the civil justice system in England and Wales (1996)*).*

These risks for potential claimants (“Litigation Risks”) may be listed as follows:

- (a) not being able to obtain a budget from their solicitor, let alone a set fee;
- (b) not being able to predict how long the litigation process will take with any degree of certainty;
- (c) a pricing policy by the lawyers requiring payment for hourly rates;
- (d) confronting:
 - (i) well resourced defendants with the capacity to obtain the best legal and expert advice; and
 - (ii) legal advice they may find difficult to understand or which does not properly identify the risks, including that the claim may fail, with the result that the claimant will not receive any money by way of judgement, will not receive reimbursement of the legal costs paid and will have to pay the other sides’ costs; and
- (e) no capacity to predict how much the potential adverse costs order may be in dollar terms.

As a result of potential claimants’ justifiable concerns about the Litigation Risks:

- (a) speculative actions are minimised; and
- (b) demand for litigation funding is high and will remain high until the Litigation Risks are better managed by the legislature, the courts and the legal profession.

4. The Supply of Litigation Funding

Litigation Funding in Australia is in its infancy. In comparison to the United States of America (the “USA”) and the United Kingdom (the “UK”), discussed below, capital investment in causes of action as an asset class is negligible.

IMF has raised about \$40 million from the Australian capital markets over the last four years, which I would estimate to be more than all other Australian litigation funder’s combined capital. The other funders are:

- Hillcrest
- Australian Litigation Fund
- Litigation Lending Services
- Firmstone

5. The Cost/Benefit of Funding

The commercial terms of IMF’s offer to fund a claim are set out in a litigation funding agreement which provides for the following:

- to pay a claimant’s legal costs and disbursements;
- to provide any “security for costs” the claimant may be ordered to provide;
- to pay any “adverse costs order”; and
- where appropriate, to assist the claimant with investigations and project management.

In return for those services, the litigation funder is entitled to receive from any “resolution sum” (i.e. money received pursuant to a settlement or judgment):

- reimbursement of all money it has expended; and
- an agreed percentage of the “resolution sum” – usually between 20% and 40%.

If the funded party receives nothing, neither does the litigation funder.

6. Is the Price of Litigation Funding Fair?

From a broad perspective, IMF's return on capital of about \$40 million over five years has been about \$5 million EBIT; being about a 5% per annum return on capital.

This return is clearly not excessive, given the infancy of litigation funding in Australia and the risks inherent in investing in this market, including the Litigation Risks.

In the Insolvency Market where litigation funding has been broadly available for about 10 years and is now provided by about five funders, there has developed a pattern of insolvency practitioners tendering for litigation funding for the larger actions, with subsequent discussions with the preferred tenderer to further negotiate terms. This competitive process in respect of litigation funding is sadly lacking in respect of the retention of lawyers for these larger projects.

Once litigation funding terms in the Insolvency Market are agreed in principal, they are then subject to review by the creditor's committee of inspection, the general body of creditors or the Courts (refer to section 477(2B) of the Corporations Act).

This Court review process has over the last 10 years or so provided over 100 decisions on what the Courts consider relevant in determining whether approval is to be given to funding agreements being entered into and in particular, whether the funder's fee is to be approved.

In Group Actions, the Courts have the power to impose conditions upon granting permission for the representative proceedings to go forward. This power extends to modifying a litigation funder's proposed terms.

It is my opinion that the only way the price of litigation funding will decrease is:

- (a) through more capital being allocated to litigation funding by the capital markets;
- (b) if the Litigation Risks are managed more effectively by the legislature, the courts and the legal profession; or
- (c) if the costs and delays in civil litigation are decreased by:
 - (i) competitive tensions being introduced into the provision of legal services and other components of litigation that do not necessarily involve legal services; and
 - (ii) the Courts being more proactive in ensuring quick and cheap resolution of the real issues in dispute.

In the USA, lawyers personally funding class actions must have their fees approved by the Court in all circumstances, where fees almost invariably are charged at around 30% of any settlement or judgment proceeds. This fee does not include assuming the risk of any adverse cost order as in the USA, costs orders are usually not made.

7. Markets

IMF funds claims that can be classified into one of three categories: Insolvency, Commercial Litigation and Group Actions.

According to the most recent IMF Investment Portfolio report, released to the ASX in October 2006, IMF had at that time investments in 34 cases (where the budgeted IMF fee is greater than \$500,000 in each case).

Of these 34 cases:

- (a) 12 are Insolvency related;
- (b) 12 are Commercial Litigation claims; and
- (c) 10 are Group Actions.

However, Group Actions, such as the Aristocrat claim and the Finance Brokers case, provide for the majority of the value of claims.

In terms of maximum claim value:

- (a) Insolvency cases comprise 15% of the total maximum claim value;
- (b) Commercial claims comprise 29%, and
- (c) Group Actions comprise 56% of the total maximum claim value.

8. IMF's Investment Protocols

IMF follows the following guidelines to gauge the value of investment opportunities when we receive new litigation proposals (not necessarily confined to shareholder actions):

- (a) the likely claim value must be more than \$2 million except under exceptional circumstances;
- (b) the likely investment is less than 10% of IMF's current assets or facilities;
- (c) the net return to the plaintiff must be reasonably high (i.e. greater than 60%);
- (d) IMF's return on investment must be at least 300% (or 100% per annum since the average investment period is about three years); and
- (e) cases must rely predominantly on documentary rather than oral evidence.

9. IMF's Due Diligence Process

If a proposal has appropriate characteristics to pass IMF's investment protocol, IMF then conducts a thorough due diligence process before deciding whether to provide funding.

We will examine the claim and ask:

- (a) What are the elements of the alleged cause or causes of action?
- (b) What evidence of each element is available? Will it be lead as documentary or oral evidence? (Documentary evidence is preferred.)
- (c) Who has these documents and who, if necessary, will be required to provide oral evidence?
- (d) Are there statute of limitation issues?
- (e) What is the prospect of the claim succeeding?

We will then examine the defence or potential cross claim and ask:

- (a) What are the elements of any potential defence?
- (b) Is the defence likely to rely on documentary or oral evidence in respect of each element of the defence?
- (c) Where are these documents and who is likely to be called to give evidence for the defence?

We then turn to quantum and ask:

- (a) What are the issues relevant to the quantum of the claim?
- (b) Is the quantum of the claim likely to be proved and disputed through documentary or oral evidence?
- (c) Where are these documents and who will be required to be called, including expert quantum evidence, if necessary?
- (d) Will the claim value, when set off against the cross claim, be unattractive?

We examine the proposed defendants by asking:

- (a) Are they capable of paying any settlement or judgment amount?
- (b) Are they capable of paying any settlement or judgment amount?
- (c) Are they insured and, if so, is the policy answerable?

We will also assess whether the claimant is someone we are prepared to have control of the proceedings.

Finally, it is important to examine the project from a broad perspective by asking:

- (a) Are the risks capable of causing the loss of the investment open to qualitative and quantitative identification within temporal and fiscal frameworks?
- (b) Is the manner in which the investment may be competently and efficiently managed capable of identification and achievement?
- (c) In which jurisdiction, Court and list will the claim be filed?

- (d) How long is the claim likely to take to reach closure of pleadings, discovery, statements, preparation for trial and judgment?
- (e) How much is this claim likely to cost for each of these phases?
- (f) How much are adverse cost orders, if made, likely to be?
- (g) Is the project economically viable having regard to the perceived risks and returns?

Any proposal must be approved by the case or state manager and then by the investment committee on an unanimous basis.

10. The UK experience

The 1979 Royal Commission on Legal Services unanimously rejected contingency fees as a way of financing litigation on the ground they would have a corrupting effect on lawyers.

However, the Thatcher Government's 1989 Green papers considered relaxing existing standards, offering a number of suggested reforms, ranging from authorising uplift fees – where a lawyer can take on a case on a “no win, no fee” arrangement, and charge an “uplift” of their normal hourly rate should the case be successful – to allowing lawyers to take a percentage of the damages upon successful resolution of a case.

It was the uplift model that was eventually adopted. Section 58 of the Courts and Legal Services Act of 1990 legitimised conditional fee agreements (i.e. involving a “no win, no fee” pricing policy) by providing for uplift fees should a case be successful. The arrangements came into operation in 1995 subject to rules laid down by delegated legislation.

As a sign of things to come, the Civil Justice Council published a paper in August 2005 entitled *Improved Access to Justice – Funding Options for Proportionate Costs – Report and Recommendations* and recommended “*Consideration should be given to the introduction of contingency fees on a regulated basis along similar lines to those permitted in Ontario by the Solicitors’ Act 2002 particularly to assist access to justice in group actions and other complex cases where no other method of funding is available*”.

Reaction of Insurers to CFAs

The introduction of conditional fee agreements, which has become the standard way of funding litigation (other than self funding), led to the introduction of a new product – **After The Event insurance**.

CFAs also enabled the abolition of legal aid for all damages and money claims, which further shifted the funding of litigation away from government towards lawyers and insurers.

ATE policies are normally taken out to cover any adverse cost order should a case be unsuccessful and the claimant's own disbursements.

The claimant's legal fees are not usually covered as lawyers are acting on a “no win, no fee” CFA.

However, in some cases ATE policies cover claimants' legal costs should the lawyer decide not to operate under a CFA.

In practice, almost all ATE policies are written on personal injury claims (CFAs were initially limited to person injury, insolvency and human rights cases. In 1998, the government extended CFAs to all civil cases except for family work) and other claims with predictable outcomes over a portfolio of cases capable of statistical analysis. They rarely feature in large commercial claims.

Access to Justice

Just a year after conditional fee arrangements came into effect, Lord Woolf released a ground-breaking report in 1996 titled *Access to Justice* which highlighted a “*lack of proportionality between legal costs and legal claims and attributed it to the “uncontrolled nature of the litigation process”*”. He recommended the Courts take a more active approach in terms of case management to control costs.

The report’s recommendations culminated in the Access to Justice Act of 1999, which further extended CFAs, for example to arbitrations and family work relating solely to financial matters and property.

But more importantly, the Act made both the premium payable (against the risk of having to pay costs), and the success fee payable by the client, recoverable from the losing defendant. This provision was first floated in a consultation paper released by the Lord Chancellor Lord Irvine in 1998. The reason, it said, was that both types of cost were incurred directly because the loser had put the successful party to the cost of taking proceedings - and they should therefore be recoverable in the same way as other costs.

The insurance industry has been strongly opposed to the recoverability of insurance premiums and success fees and the jury is out on whether its opposition will be effective.

As of two years ago, there were some 60 providers of After The Event insurance in the UK.

Premiums have soared. The UK Office of Fair Trading said in December 2004, announcing a review of liability insurance markets, that there were concerns that the ATE insurance combined with conditional fee agreements were “*contributing to rising legal costs for personal injury claims which in turn are contributing to rising liability insurance premiums*”.

Claims management companies have also become common. These companies solicit claims and then farm them out to solicitors on their panel for a referral fee. Typically, lawyers take such cases on the basis of their usual costs, which are covered by “both sides insurance”. A number of high profile claims managers have fallen into financial difficulties, such as Claims Direct, which was listed on the London Stock Exchange in July 2000 but went into administration two years later with massive debt.

11. The USA Experience

The Economist reported in August 2005 that it had been a “*blazing summer*” for shareholder lawsuits in the United States of America (the “USA”).

Total settlements have increased from \$145 million in 1997 (in 2005 money) to \$5.5 billion in 2005, whilst the number of lawsuits remained relatively constant, according to Cornerstone Research, which monitors class action filings.

Over a five-year period, the average public corporation has a 10% probability that it will face at least one shareholder class action lawsuit.

However, there a number of differences between the USA and Australian legal systems that suggest that Australia is not likely to witness the same proliferation of securities laws suits as has the USA.

The American Experience

In the USA:

- (a) trial lawyers are entitled to charge a percentage of the recovery in consideration for their services; and
- (b) Courts do not generally grant adverse cost orders.

In class action claims, there is invariably a rush by trial lawyers to have the first suit filed due to the Court’s favouring the lawyers who first file the suit in their decision as to which suit will proceed.

The successful trial lawyers then become entitled to a reasonable percentage of the recovery by everyone in the class under the guidance of the Courts, without the trial lawyers seeking or needing the class members to agree to this pricing policy.

As a result of the structure referred to in the three preceding paragraphs:

- (a) there have been a great number of class actions taken, particularly in respect of shareholder actions alleging fraud on the market (“Private Attorney” claims);
- (b) there are actions which are commenced before there has been a proper appraisal of the claim’s value; and
- (c) some trial lawyers expect the defendants to settle (from which the trial lawyers will be paid) even if the claim has little or no substance.

The Australian Experience

In Australia:

- (a) lawyers are ethically restricted from charging a fee proportionate to the recovery, given their fiduciary duties to their clients; and
- (b) the indemnity principle ensures that the successful party in litigation recovers the cost of that litigation from the unsuccessful party.

Litigation funders will not fund commencement of proceedings unless and until:

- (a) a viable cause of action is identified, valued and costed (including the potential for an adverse cost order); and
- (b) there are sufficient shareholders who wish to enter into funding agreements with sufficient loss to make the litigation commercially viable.

As a result of the structure referred to in the two preceding paragraphs:

- (a) there have been very few Group Actions taken in Australia to date;
- (b) they are not commenced before there has been a proper appraisal of the claim's value; and
- (c) no speculative proceedings are funded as to do so risks the loss of the investment and payment of adverse cost orders.

Unfunded representative proceedings that respondents successfully defend almost invariably result in unenforceable cost orders as no solvent person in their right mind would undertake the Litigation Risks on behalf of all the other members of the group. Accordingly, an unsustainable situation arose whereby a cost for lead plaintiffs, being parties to the straw, were unable to fulfill their responsibilities when the litigation was lost and an order was made in favour of the defendant.

If the lead plaintiff receives litigation funding then this will ensure that successful defendants receive their taxed costs and, in appropriate cases, all of their costs on an indemnity basis.

If there is any doubt about the funder's capacity to pay the adverse costs in due course then the Court can make an order that the lead plaintiff provides security for costs and if the litigation funder does not provide that security then the litigation will not go forward.

The lead plaintiff in an Australian Group Action cannot agree, on behalf of all of the members of the group, that the litigation funder will receive a percentage of each group member's judgment. Nor, it appears, can the Court currently make such an order. As a result, litigation funders may only fund Group Actions in Australia where each member of the group has signed a litigation funding agreement. It is virtually impossible for the litigation funder to fund all members of the group. Accordingly, the group is generally defined as those persons who have suffered loss at the hands of the particular defendant and who have signed a litigation funding agreement. By definition, this will be a smaller group than those who have suffered loss at the hands of the defendant.

In the USA, as class actions are funded by the solicitors, this issue does not arise i.e. the lead plaintiff agrees the percentage with the solicitor and that percentage is ratified by the Court. There is no requirement for each member of the class to make a separate agreement with the solicitor.

The result is that in Australian Group Actions the litigation will be conducted on behalf of a sub set of the group, being only those who are prepared to pay for the proceeding by forgoing part of their entitlement in favour of the litigation funder.

Australia is fast coming to the position that meaningful (and large) cost orders will be made against lead plaintiffs in unsuccessful Group Actions and it is this fact which clearly differentiates the USA and Australian systems.

Punitive Damages

Most civil litigation systems in the USA include a punitive element in their damages i.e. a payment by the defendant to the plaintiff as a punishment of the defendant. By way of example, the recent Texas verdict in the *Vioxx* case against the pharmaceutical company Merck totalled US\$253,450,000 of which US\$229,000,000 was in the nature of punitive damages (the actual economic loss was only US\$450,000). It is the possibility, if not the probability, of this very high punitive payment which encourages class actions in the USA.

No such system applies in Australia. A plaintiff in a Group Action in Australia will receive recompense for economic loss and, in appropriate cases, damages for personal injury but in no case will an award of damages be made in order to punish the defendant.

The Jury System

Even in a litigation system where punitive damages may be paid, such damages will be restrained if a judicial officer, used to dealing with such cases, makes the damage determination.

This is also the case in relation to general damages for economic loss and for personal injury.

In the USA such determinations are routinely made by juries whereas in Australia the almost invariable practice is that these cases come before a judge sitting alone.

The USA system therefore contains the potent mix of punitive damages in the hands of untrained juries which are only too happy to punish big business in favour of the individual.

This circumstance simply does not arise in Australian Group Actions.

Depositions

It will almost always be the case in any Group Action that the facts are best known by the officers of the defendant.

In the USA the plaintiff has an early and potent opportunity to get at these facts and those officers. The plaintiff is entitled to depose the officers of the defendant (i.e. question the officers on oath).

This is a powerful tool in the hands of a class action lawyer.

The only similar tool available to Australian Group Action lawyers is the relatively staid right to deliver written interrogatories and as yet untested discretionary powers.

Settlement

All of these elements come together in the question of settlement. A Group Action will be much more readily instigated if there is a high chance of early settlement.

In the USA the class action defendant faces a jury armed with the power to award punitive damages in circumstances where the plaintiff does not have to pay for failure and the officers of the defendants are put under the spotlight from the beginning.

This leads to early high levels of settlement and to allegations that many unmeritorious class actions are instigated with the knowledge that many defendants will settle even though they do not believe they are liable.

This situation does not appertain in Australia. The Australian Group Action defendant faces a judge who has heard it all before, who does not have the power to award punitive damages and who will invariably award costs, and in some cases indemnity costs, to successful defendants. Rather than have an early confrontation by way of deposition the Australian Group Action defendant can (and generally does) put off the evil day for many years happy to run the plaintiffs out of patience or funds or both.

12. What are the Likely Funded Causes of Action against Insureds?

For the cases that are pursued, the following provides an outline of the most common claims pleaded in shareholder Group Actions.

Shareholder Claims

- (a) Disclosure documents protection:
 - s 710(1) – compulsory disclosures in a prospectus
 - s 728(1) – disclosure documents must not be misleading
 - s 728(2) – must have reasonable grounds for making a statement about the future
 - s 729(1) – list of people from whom a shareholder may recover, including “6. a person who contravenes, or is involved in the contravention of, ss 728(1)”
- (b) Continuous disclosure protection:
 - s 674(2) – compulsory notification of information a reasonable person would expect, if it were available, to have a material effect on the price or value of the shares
 - s 674(2A) – a person involved in the companies’ contravention contravenes this section
- (c) Protection from misleading and deceptive conduct
 - s 1041H – a person must not engage in misleading or deceptive conduct, or conduct that is likely to mislead or deceive, in relation to a financial product
 - s 769C – representations about future matters are misleading unless representor has reasonable grounds

Claims against Directors

In an action for damages under the Corporations Act or Trade Practices Act, investors can claim damages against a person who directly engaged in the misconduct or against “any person involved in the contravention”: section 1041I of the Corporations Act, section 82 of the Trade Practices Act.

It is commonly pleaded that the defendant company engaged in the contravening conduct is

the principal offender, whilst individuals, such as directors, are alleged to have an “accessorial liability”.

A “person involved in a contravention” is defined in section 79 of the Corporations Act and section 75B of the Trade Practices Act as a person who:

- (a) has aided, abetted, counseled or procured the contravention;
- (b) has induced, whether by threats or promises or otherwise, the contravention;
- (c) has been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention; or
- (d) has conspired with others to effect the contravention.

The Corporations Act also contains other breaches for which directors may be liable, and thereby be exposed to pecuniary penalty orders (section 1317G) and compensation orders (section 1317H):

- (a) failure to exercise and discharge duties with due care and diligence (section 180);
- (b) failure to exercise powers and discharge duties in good faith and for a proper purpose (sections 181 and 184(1));
- (c) improper use of position as a director or officer of corporation for personal advantage or to cause detriment to the corporation (sections 182 and 184(2));
- (d) improper use of information obtained in office for personal advantage or to cause detriment to the corporation (sections 183 and 184(3)).

Finally, section 588G of the Corporations Act, creating a statutory duty upon directors to ensure the companies they control do not incur further debts after the companies are insolvent, will continue to be breached as directors unreasonably believe their companies' fortunes will improve.

Rehana Box in her July 2006 article “Directors and Officers Indemnification and Insurance Update” provided a brief overview of other provisions of the Corporations Act which may give rise to personal liability for directors, being Attachment “A” to this paper.

Claims against Professionals

Finally, professional indemnity claims will continue even though limited liability has clearly decreased the ability of clients to successfully obtain large pay outs from their professional wrongdoers. The pressures experienced by the legal profession by their bank clients against this limited liability push are an indication that there will always be a real risk for insurers to manage on behalf of their professional insureds.

13. Litigation Management by Funders and Insurers

Insurers, when managing claims by indemnified, defendant insureds, are also in the business of providing litigation funding. Under the typical insurance contract, the insurer agrees to fund any litigation in relation to the risk and the insured agrees to hand over control of the litigation to the insurer. Insurers, like funders, determine which claims are prosecuted and defended, choose the lawyers, instruct and pay the lawyers and indemnify the insured in respect of adverse cost orders. None of these activities are currently regulated, leaving insurers, like funders, currently unaccountable for these activities.

It is clear that insurance against risk has been an enormous advantage to society. This is so despite the fact that most insurance contracts savours of maintenance. This is especially the case with professional indemnity, directors and officers, legal expense and After The Event insurance, where the insurable event is or likely involves disputation or litigation and the insurer has absolute control of any litigation which eventuates.

The Court of Appeal in *Clairs Keeley (A Firm) v Treacy* stated that:

“...in terms of risk of abuse, there may be no difference between a litigation funder with an eye to maximising profits and an insurance company with an eye to minimising losses. Indeed, it may be said that the litigation funder has a greater incentive to ensure that he conducts himself properly. Not only are the funder’s activities likely to be the subject of close scrutiny, but any transgression is likely to have a markedly deleterious effect on the funder’s ability to conduct business in the future. By contrast, only a small portion of an insurer’s business is likely to lead to litigation.”

In addition, litigation funders are always able to assess the actual risks before they eventuate whereas insurers, other than After The Event insurers, rely upon statistical data.

Austin J in *ACN 076 673 875 Ltd* said:

“... there is the commercial reality that IMF would not, acting rationally, prosecute litigation at its expense unless there were a reasonable prospect of a verdict or settlement ...”

The insurance analogy also illustrates the regularity of informed arrangements whereby solicitors represent both insurer and insured as principals, even though conflicts of interest may arise. In cases of conflict of interest, the law prescribes the duties of the various parties including the solicitors involved. The law assumes that a lawyer-client relationship exists between the solicitor, appointed by the insurer, and the insured, but not necessarily to the exclusion of a similar relationship with the insurer? Both insurers and the solicitors they appoint owe a duty to the insured to conduct the proceedings with due regard to the latter’s interests and an action for damages will lie for breach of that duty. Additionally, insurers have the right to decide upon the proper tactics to pursue in the conduct of the litigation, provided that they do so in what they *bona fide* consider to be in the interests of themselves and the insured. When the insurer takes over the conduct of the insured’s defence, each party comes under an obligation, as a matter of contractual implication, to act in good faith with due regard to the interests of the other.

The common law rules that have been formulated to deal with insurance contracts are readily adaptable to the regulation of litigation funders presently under consideration. Indeed, there

seems no reason in principle or policy for a funder's involvement in litigation to be regulated differently to insurers. At the extreme, if funders are regulated in an environment where insurers remain unregulated, there will be a tendency to worsen the inequality of arms between claimants and insurers presently so clearly in existence.

The majority of the High Court of Australia in *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* [2006] HCA 41 at paragraph 84 found none of the following elements, alone or in combination warranted condemnation as being contrary to public policy:

- (a) the funder seeking out those who have claims;
- (b) the funder controlling the litigation; and
- (c) the funder hoping for and expecting a significant profit.

Further, the majority at paragraph 93 noted that:

"...if lawyers undertake obligations that may give rise to conflicting duties there is no reason proffered for concluding that present rules regulating lawyers' duties to the court and to clients are insufficient to meet the difficulties that are suggested might arise."

Accordingly, if criteria for legally acceptable funding agreements are considered necessary, they should be equally applicable to insurance contracts. These criteria could usefully be segregated between:

- (a) financial and insurance services where criteria could almost exclusively focus on consumer protection, having regard to existing regulation; and
- (b) litigation management services by funders and insurers which at present are not regulated.

In particular, despite funders and insurers having a greater capacity than most parties to systematically assist or retard the Court in achieving just, quick and cheap resolution of the real issues in dispute, only the Court, the Parties and the lawyers have duties in respect of achieving this overriding purpose.

14. Just, Quick & Cheap Resolution of the Real Issues

After reciting that the overriding purpose of the Civil Procedure Act 2005 (NSW) is to facilitate the just, quick and cheap resolution of the real issues in proceedings (sub section 56(1)), the Act:

- (a) obliges the Court to seek to give effect to that overriding purpose when it exercises power or interprets any provision of the Act or Rules (sec 56(2));
- (b) obliges the parties to civil procedures to assist the Court to further that overriding purpose (sec 56(3)); and
- (c) prohibits lawyers from causing their clients to breach their duty to the Court (sec 56(4)).

Litigation funders, including insurers, have a greater capacity than most to systematically assist or retard the Court in achieving the overriding purpose.

With these concerns in mind, it seems appropriate to:

- (a) require parties to inform the Court, at the commencement of proceedings, if the conduct of their case is to be funded in whole or in part by a third party and, if so, to identify that party; and
- (b) change sub section 56(3) of the Civil Procedure Act so that it reads:

“A party and any person paying any part of the legal costs of a party to civil proceedings is under a duty to assist the court to further the overriding purpose...”

The utilisation of our Courts by the insurance industry for much of its claims management function is not subject to adequate regulation or accountability. The current inquiry into the litigation funding industry by the Standing Committee of Attorneys General should focus not only on consumer protection but also on the reasons for such high consumer demand for litigation funding. Such an inquiry would inevitably identify the costs and delays involved in our adversarial processes as the most important.

Making funders, including insurers, accountable for their involvement in the Court process in the same way as the parties themselves, seems an obvious means of better protecting and promoting the interests of the Courts as well as the interests of the consumers of the Courts' services.

15. Civil Justice Reform

Wayne Martin, the new Chief Justice of the Supreme Court of Western Australia in August 2006 referred to his State's justice system as the: *“Rolls Royce of justice systems in the sense that it is the best that money, a lot of money, can buy. But there isn't much point in owning a Rolls Royce if you can't afford the fuel to drive it where you want to go. You can polish it, admire it and take pride of ownership from it but it doesn't perform its basic function sitting in the garage.”*

Unfortunately, there has been limited interest shown to date by governments, the courts and the legal profession in seeking input from consumers of the civil justice system as to what they want from the system and how they may access the system in a cost efficient manner.

Indeed, the Chief Justice of the High Court in August 2006 acknowledged that it is questionable whether we have a civil justice system where judges, the parties and their lawyers do not work towards common objectives; where, adversaries looking after their self interests principally determine the cost and time proceedings take, with the judiciary having limited capacity to influence these factors.

This acknowledgement needs to be the turning point for Attorneys-General to realise reform is not only inevitable; it is required now.

Fundamental reform will involve:

1. the Governments amending their statutes to facilitate viable enforcement of our statutes and common law and, in particular, making lawyers' duties to their clients subject to their duties to the courts;
2. the courts acknowledging their overriding purpose is to provide fair, quick and cheap resolution of claims and changing their cultures and processes to achieve their purpose; and
3. consumers and prospective consumers of our Courts services advocating their right to access justice.

These measures will be unpalatable to many in the justice system, despite the likelihood of the courts, their officers and the laws of our land becoming less relevant and less respected if the status quo is permitted to remain.

On 30 August 2006 the High Court in its *Fostif* decision took a step in the right direction in endorsing litigation funding. But there is a need for more extensive change. The main question is how and when it will be achieved.

The answer will, as is usual in a democracy where the performance of one of its pillars is questioned, come from voters and, in particular, anyone who would want to enforce their legal rights if they had any viable access to the Courts. This is a large constituency, including consumers of goods and services.

We need our governments collectively and uniformly to address access to justice issues as the United Kingdom did commencing with the Woolf reforms and culminating in Access to Justice legislation. Every facet of our adversarial processes needs to be questioned to determine its viability from a cost/benefit perspective.

After using the Rolls Royce analogy, Chief Justice Martin went on to say: *“It might be time to consider trading our Rolls Royce for a lighter, more contemporary and more fuel efficient vehicle which will get us where we need to go just as effectively and perhaps more quickly.”*

A version of this vehicle was identified 10 years ago by former Queensland Court of Appeal judge, Geoff Davies, as involving:

- the existing litigation process being simplified and accelerated;
- alternate means being provided for resolving disputes and, in appropriate cases, parties encouraged to use them;
- abandonment of lawyers charging by reference to time spent;
- making costs more predictable so that a potential litigant may obtain a firm quote before embarking upon litigation; and
- moving from lawyers wishing to win at all costs and judges merely deciding cases to all involved in our civil justice system seeking to achieve fair, quick and cheap resolution of civil claims.

To this list, I would also add:

- funders and insurers being required to disclose their involvement and to owe the court a duty to seek fair, quick and cheap resolution of claims;
- monetary demotivation of defendants causing diversion and delay and plaintiffs seeking excessive awards; and
- collation of data on the performance of all parties enabling accountability.

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