

Litigation funding in Australia

**Discussion Paper
Standing Committee of Attorneys-General
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Note: This Discussion Paper does not necessarily represent the views of the Standing Committee of Attorneys-General or any individual Attorney-General.

Litigation funding in Australia

In November 2005, the Standing Committee of Attorneys General (SCAG) agreed that further consultation and research should be undertaken into regulating the litigation funding industry.

This paper sets out the legal context of litigation funding, and some issues upon which comment is invited. Results of the consultation will be considered by SCAG, and together with forthcoming High Court decisions on the topic, will be used to inform the decisions of Ministers in the development of any regulatory proposal.

An electronic copy is available for download at:

http://www.lawlink.nsw.gov.au/lawlink/legislation_policy/ll_lpd.nsf/pages/lp_dp.

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1. Litigation funding in Australia

1.1 Contemporary snapshot of litigation funding

A litigation-funding company (LFC) is a commercial entity that contracts with one or more potential litigants. The LFC pays the cost of the litigation and accepts the risk of paying the other party's costs if the case fails. In return, if the case succeeds, the LFC is paid a share of the proceeds (usually after reimbursement of costs). The share of the proceeds is as agreed with the client, and is typically between one-third and two-thirds of the proceeds, though in some insolvency cases it has been 75% of the award.

Despite more than 20 court challenges to these arrangements over the last 8 years, none of these contracts have been struck down in Australian courts. Some actions were stayed however, until the LFC and solicitors had altered the contracts and provided the plaintiffs with sufficient information to allow for informed consent to the terms of the arrangement.

Commercial funding of litigation in Australia has grown out of a statutory exception for insolvency practitioners (see below). Currently there are five “for profit” LFCs in Australia. Most litigation funding is still conducted under the statutory exception for insolvencies, and involves, for example, pursuing voidable transactions and misfeasance by company officers.

The remainder of funded cases, outside the insolvency context, is usually limited to commercial litigation with large claims (over \$500,000, or for some LFCs, over \$2 million). An exception is for class actions, where a large number of smaller claims can be processed economically (eg. petrol or tobacco tax refunds). LFCs are generally not involved in personal injury type matters or other smaller claims, as the associated costs and risks make them unviable.

1.2 Historical background, and development of the industry

Champerty and the common law exception

Improperly encouraging litigation (‘maintenance’) and funding another person’s litigation for profit (‘champerty’) were once torts and crimes in all Australian jurisdictions.

The common law prohibition of litigation funding was justified in part by a doctrinal concern, namely that the judicial system should not be the site of speculative business ventures. However, the primary aim was to prevent abuses of court process (vexatious or oppressive litigation, elevated damages, suppressed evidence, suborned witnesses) for personal gain.

Courts only allowed litigation funding to occur pursuant to settled common law exceptions: if there was a bona fide community of interest between plaintiff and the funder, or if the plaintiff was impecunious and the funder was not acting with any collateral motive.

Today, it seems likely that maintenance and champerty are obsolete as crimes at common law,¹ and legislation in the Australian Capital Territory, New South Wales, South Australia and Victoria has expressly abolished maintenance and champerty as a crime and as a tort.²

In these jurisdictions, there is no criminal or civil liability for maintenance and/or champerty, but the abolishing legislation does ‘not affect any rule of law as to the cases in which a contract is to be treated as contrary to public policy or as otherwise illegal’.³ Courts could stay an action or set aside an agreement if it is found to be inconsistent with public policy considerations upon which the prohibition was based at common law.

To that extent, the considerations for courts in relation to litigation funding in NSW, Victoria, South Australia and the ACT are similar to those in Queensland, Western Australia, Tasmania and the Northern Territory, where the torts of maintenance and champerty have not been abolished.

The statutory exception and access to justice

Since 1995, a new statutory exception to the rule against champerty has developed. Under their statutory powers of sale,⁴ insolvency practitioners may now contract for the funding of lawsuits, if these are characterised as company property. Many such actions are for voidable transactions or misfeasance by company officers.

Litigation funding companies emerged to service this market, and most litigation funding continues to be under the statutory exception for insolvencies. However, a number of LFCs have recently begun to fund non-insolvency plaintiff lawsuits.

Access to justice has become a powerful consideration for courts in assessing these new funding arrangements. Where challenged by defendants on the grounds of maintenance and champerty, it is the importance of access to justice which has generally led courts in Australia and the UK to approve funded proceedings. As mentioned above, despite numerous challenges in the last decade, no funding agreements have been struck down in Australian courts. However, as noted above, some actions have been stayed until the LFC and solicitors altered the contracts and provided the plaintiffs with sufficient information to allow for informed consent.

1.3 Case examples

An example of an insolvency matter for which funding was provided is as follows.

The shareholders and creditors of a company in liquidation wished to get a judgement against the company set aside, on the grounds that it was obtained by fraud. The liquidator entered into a funding agreement with an LFC. The LFC provided funds to the company so that it could become a party to the proceedings instituted by its

¹ See dicta in *Clyne v NSW Bar Association* (1960) 104 CLR 186, 203; *Brew v Whitlock* [1967] VR 449, 450.

² *Civil Law (Wrongs) Act 2002* (ACT) s 221; *Maintenance, Champerty and Barratry Abolition Act 1993* (NSW) 3, 4, 6; *Criminal Law Consolidation Act 1935* (SA) Sch 11 ss 1(3), 3; *Wrongs Act 1958* (Vic) s32 and *Crimes Act 1958* (Vic) s322A.

³ See eg, *Maintenance, Champerty and Barratry Abolition Act 1993* (NSW) s 6; *Wrongs Act 1958* (Vic) s32 (2).

⁴ For example, the powers of disposal given to a receiver to dispose of a company’s property under the *Corporations Act 2001* (Cth): s 420(2)(b) and (g). See also the powers of disposal accorded to a liquidator by *Corporations Act 2001* (Cth) s 477(2)(c). Statutory powers of sale also arise from provisions of the *Bankruptcy Act 1966* (Cth), and for trustees in all jurisdictions.

shareholders: *Anstella Nominees Pty Ltd v St George Motor Finance Ltd* [2003] FCA 466. (For more detail on how such arrangements may be structured, see Appendix 1).

Funded non-insolvency matters show greater variety than those in the insolvency field. Two recent examples of funded non-insolvency matters are as follows.

QPSX Ltd v Ericsson Australia Pty Ltd [2005] FCA 933: QPSX and its subsidiaries issued proceedings against Ericsson and a number of other corporations, for breach of a licensing agreement and for misleading and deceptive conduct. The estimated maximum claim value was over AUD \$50 million. Given that QPSX intended to issue a number of other similar proceedings, it entered into a litigation funding agreement (payment of legal costs and indemnity for adverse costs orders, up to a specified limit) as a risk-management strategy. QPSX retained its own lawyers (presumably under the usual costs agreement), and there was no contract between the lawyers and the LFC.

Fostif v Campells Cash and Carry [2005] NSWCA 83: In 1997 the High Court found that legislation authorising a licence fee on tobacco sales was invalid. Retailers continued to pay the fee to wholesalers for several weeks, but the fees were not passed on to the government nor refunded, and the wholesalers made windfall profits. A number of small retailers started representative, opt-in proceedings against the wholesalers, to recover the fees. Given their cost and complexity, and the relatively small amount owing to each retailer, these proceedings could not have been financially possible without the funding and assistance of an LFC. In this case, the lawyers were selected by the LFC and worked to an agreed budget.

In September 2005, the defendants in this case were granted special leave to appeal to the High Court. The grounds of appeal include issues of maintenance and champerty. The case will be considered together with a funded petrol fee matter, *Trendlen v Mobil Oil* [2005] NSWSC 741.

2. Benefits and challenges of litigation funding

2.1 Benefits of Litigation funding

In the insolvency context, litigation funding plays an important role in permitting creditors to pursue wrongdoers or actions where this would otherwise be impossible due to lack of funds. The funding reduces risks for the creditors and the insolvency practitioner in undertaking the litigation – because losses are insured against, they know that they are not ‘throwing good money after bad’.

In addition to providing access to justice, litigation funding in the insolvency context has other advantages.

Funding provides low risk, equal recovery for all creditors. (This would not be the case if richer creditors decided to fund the litigation privately. Since they had financed the recovery proceedings, they would then require a larger cut of the proceeds).

Funding assists resolution of insolvencies in an orderly and expeditious way. It also encourages enforcement of the *Corporations Act* by allowing more breaches to be pursued. It may therefore create a greater deterrent effect, as well as providing the potential for precedent to develop against those corporate defendants who would not normally have any suits against them, due to lack of creditor funds. This may in turn assist the Australian Securities and Investments Commission (ASIC) in pursuing matters under the *Corporations Act*.

Outside the insolvency context, litigation funding similarly ensures access to justice for some meritorious claims which would otherwise be abandoned. This is particularly the case in class actions, where the expense is too great to be borne by any one claimant; and in complex matters, where the initial costs of investigation and collecting expert evidence may be prohibitive.

Further advantages of non-insolvency litigation funding are:

- Levelling the playing field. With their strategic and investigative expertise, as well as their funds, LFCs assist plaintiffs to take action against wealthy or insured defendants. Similarly, LFCs’ experience may assist in providing cohesive direction to large class actions.
- Introducing budgeting for legal costs. As experienced, well-resourced repeat players, LFCs can supervise the provision of legal services and ensure that costs are kept to a minimum. For example, some LFCs require solicitors to work to a budget. Litigation funding has the potential to create more competition in the pricing of legal services.
- Finally, litigation funders must be well capitalised, so defendants are better assured that they will recover their costs, should a costs order be made against an unsuccessful plaintiff.

2.2 Challenges of litigation funding

These arise primarily outside the insolvency sphere.

Litigation about legal status - The High Court has not yet ruled out the existence of common law criminal liability for maintenance, and the tort of champerty has not been

abolished in several Australian jurisdictions. Meanwhile, there have recently been changes in the considerations emphasised by courts. There is a lack of legal certainty around non-insolvency litigation funding.

Where challenged, funding agreements are individually assessed on public policy grounds, or funded proceedings individually checked for abuse of process. Thus, there have been numerous defendant challenges to funded proceedings on the basis of champerty or abuse of process. There has also been litigation about discovery of the funding agreements themselves. This ‘satellite’ or ‘collateral’ litigation drags out proceedings and diverts the plaintiff’s resources – and those of the courts - from the true issues of the case.

The forthcoming decisions of the High Court in the *Fostif v Campbells Cash & Carry* and *Trendlen v Mobil Oil* cases may provide some guidance in this area.

Vulnerable consumers - The potential vulnerability of non-insolvency plaintiffs raises consumer protection issues. Non-insolvency plaintiffs, like the tobacco retailers, may not always have legal knowledge, and may not be well placed to negotiate a funding contract, to assess the terms they agree to, or to retain adequate control over the proceedings. This is in contrast to insolvency practitioners, who are well versed in the relevant legal issues and in assessing and negotiating contracts. In addition, insolvency practitioners have a fiduciary duty towards the creditors, and are under an obligation to retain control of the proceedings.⁵

Inadequacy of protections - The existing consumer protections may be insufficient.

- Existing protections include Trade Practices and Fair Trading laws, fiduciary duties owed to the plaintiff by the LFC, and fiduciary and other duties owed to the plaintiff by the lawyers in charge of the matter. All of these provide retrospective remedies, and require the plaintiff first to notice a problem with the LFC’s contract or conduct, and second to have both the funds and the wherewithal to pursue a remedy. Some funded plaintiffs are sophisticated repeat players (as in *QPSX v Ericsson*), but in the case of a funded, non-insolvency matter these conditions for protection cannot be assumed.
- In addition, litigation funders which hold an Australian Financial Services Licence (AFSL) granted by ASIC are subject to two sorts of pro-active consumer protection obligations. On one hand, they have obligations with regard to their financial status. These obligations are contained in the AFSL itself. On the other hand, AFSL licencees (and those who do not hold a licence but are required to do so) have statutory obligations to disclose to the client the risks and benefits of the arrangements including fees and commissions, and all other significant features of the proposed agreement.⁶ Such disclosure is a protection in that it provides consumers with the risk information necessary to enable them to make an informed decision.

However, not all LFCs are required to hold an AFSL, and one LFC has been granted conditional relief from holding such a licence. This means that not all funders of litigation funders have the benefit of the pro-active consumer protections provided by the AFSL.

⁵ Lightman J in *Groewood Holdings Plc v James Capel & Co Ltd* [1995] Ch 80; *Anstella Nominees Pty Ltd v St George Motor Finance Ltd* [2003] FCA 466.

⁶ See Chapter 7 of the Corporations Act 2001 (Cth), especially Part 7.9 of that Act.

- Some current protections for the client are premised on the existence of a solicitor-client relationship, but not all funding agreements ensure such a relationship. For example, in *Marston v Statewide Independent Wholesalers Ltd* [2003] NSWSC 816, the retainer explicitly stated that the lawyers would not liaise with the plaintiffs, and that the funder signed as a principal (and not as the plaintiffs' agent). Similarly, in *Clairs Keely (A firm) v Treacy*,⁷ the litigation funder had entered a direct retainer with the solicitor, and the "plaintiff" had no contract with the solicitor. The solicitor in that case did not seem to appreciate that they owed duties to the plaintiff, and only dealt with and took instructions from the LFC.
- Finally, supervision by the courts is not guaranteed. Many funded cases settle without going to court, and courts will only look at the funding arrangement if the defendant challenges it as an abuse of court processes or otherwise contrary to public policy.⁸ In *Clairs Keeley*, it was the defendants' challenge to the proceedings on the ground of abuse of process which brought to light the problems with the funding arrangements – and which ultimately secured protection for the plaintiffs.⁹ However, the NSW Supreme Court in *Fostif v Campells Cash and Carry* recently indicated that the nature of the contract between the claimant and the LFC is of no interest to the defendant: the court held that the rule against champerty exists to protect court process and the defendant, rather than to protect the person making the champertous agreement.

Outside the insolvency context, there is legal uncertainty around funding contracts and funded proceedings. Meanwhile, in their dealings with LFCs, funded plaintiffs may be more vulnerable, and have little prospect of supervision or redress.

It should be noted that though the legal status of litigation funding at common law is to be clarified by the *Fostif* and *Trendlen* cases, the lack of legislative uniformity across Australia will remain. The decisions might not address broader questions of consumer protection, or the provision of litigation insurance and not-for-profit litigation funding.

Because the challenges of litigation funding arise primarily in the non-insolvency area, the rest of the discussion paper will focus on issues outside the insolvency sphere.

⁷ [2003] WASCA 229 (3 December 2003).

⁸ This is in contrast to litigation funding of matters run by a liquidator, where leave of the court is generally obtained before entering into a funding arrangement: *Corporations Act 2001* (Cth) s 477(2B).

⁹ Two factors were relied on by the defendants in seeking a stay. First, there was a secret agreement between the LFC and the solicitors it had hired, which would result in the solicitors gaining a substantial success fee (25% above their normal fee). This agreement had not been ratified by the plaintiffs. Second, as a result of the success fee, the plaintiff's solicitors had breached their fiduciary duty to the plaintiffs by placing themselves in a position in which their interest conflicted with that of their clients. A stay was granted. It was ultimately lifted once the retainer and agreement had been rectified, and the clients had given their informed consent for the proceedings to continue: *Clairs Keeley v Treacy* [2005] WASCA 86 (10 May 2005).

3. Issues for discussion

3.1 Objectives

In November 2005, SCAG Ministers identified the following principles to be borne in mind when considering regulation of litigation funding:

- The importance of protecting consumers of litigation funding, (and especially, ensuring full disclosure to, and informed consent by, clients of funders)
- The desirability of national consistency
- The need to promote broader access to justice

The issues for discussion will address the challenges of litigation funding in light of these three objectives. The areas considered are for-profit litigation funding (outside the insolvency field), and not-for-profit litigation funding. The related question of insurance is also considered.

3.2 For-profit litigation funding

Clarifying the legal status of litigation funding

In order to prevent defendants using ‘collateral’ or ‘satellite’ litigation to stymie proceedings, the legal status of non-insolvency litigation funding arrangements could be clarified, and made uniform throughout Australia.

Issue 1: Should laws against maintenance and champerty be repealed in those jurisdictions where the tort or crime continues to exist (Western Australia, Queensland, Tasmania and the Northern Territory)?

Ensuring a direct lawyer-client relationship

It is important to ensure that the lawyers’ fiduciary obligations to the plaintiff are explicitly engaged in any funded proceedings.

Issue 2: Should a direct contractual agreement between the solicitor and the plaintiff/s be required in all funded actions?

This would guarantee that the broad consumer protections set out in the Uniform Legal Profession laws apply to the lawyer-plaintiff relationship. It would also promote full disclosure to the plaintiff by the lawyer for the matter, and allow them to make informed decisions regarding the conduct of proceedings.

Identifying criteria for evaluation

A critical question to be answered is whether – and which – LFC activities should be authorised by legislation. Legislation would greatly lessen the likelihood of common law challenges to specific LFC activities. Preventing unnecessary collateral litigation will have the benefit of increased proceeds going to plaintiffs, as a result of lower legal costs. Ideally, greater contractual certainty would reduce premiums, as would the deepening of the market which may result. One possibility is to set out the criteria against which the courts should assess whether the funding arrangements are contrary to public policy.

These might include the following considerations, as derived from recent cases in the Supreme Courts of Western Australia and NSW, and in the Federal Court.

- whether there is a direct retainer and costs agreement between the plaintiff and the solicitors¹⁰
- whether the solicitors were chosen by the plaintiff¹¹
- the sophistication of the plaintiff¹²
- whether there has been adequate disclosure to the plaintiff by the funder¹³
- whether the plaintiff is in a position to make informed decisions regarding the conduct of proceedings¹⁴
- whether independent advice is reasonably available to the plaintiff¹⁵
- whether the funder has excessive control over proceedings¹⁶
- whether the funder has liability for the successful defendants' costs¹⁷

(These criteria echo the usual common law considerations currently used in assessing funded insolvency matters, including:

- whether the creditors' approval for the funding agreement has been obtained¹⁸
- if the liquidator has obtained a legal opinion to the effect that there is no indication that the claim should not be pursued¹⁹
- whether the funder/insurer has limited rights to interfere in proceedings²⁰
- whether the liquidator maintains control over settlement proposals²¹)

Alternatively, a narrower approach could be taken, in which legislation sets out the necessary features for a valid funding agreement. Without affecting the court's discretion to consider the question of abuse of process, such criteria would achieve a nationally uniform approach for funding arrangements or funded proceedings. By clearly indicating the features of acceptable funding arrangements, they would also dissuade unnecessary applications to stay or strike out funded proceedings.

Issue 3: Should the criteria for legally acceptable funding agreements be formalised?

¹⁰ See *Clairs Keeley v Treacy* [2003] WASCA 229 (3 December 2003), *Clairs Keeley v Treacy* [2004] WASCA 277, *Clairs Keeley v Treacy* [2005] WASCA 86, *Spatialinfo Pty Ltd v Telstra Corporation Ltd* [2005] FCA 455.

¹¹ See *Dorajay Pty Ltd v Aristocrat Leisure Ltd* [2005] FCA 1483.

¹² See *QPSX v Ericsson Australia* [2005] FCA 933; *Dorajay Pty Ltd v Aristocrat Leisure Ltd* [2005] FCA 1483.

¹³ See *Clairs Keeley (a firm) v Treacy* [2005] WASCA 86.

¹⁴ *Ibid.*

¹⁵ See *Clairs Keeley (a firm) v Treacy* [2005] WASCA 86, *Volpes v Permanent Custodians* [2005] NSWSC 827.

¹⁶ See *Fostif Pty Ltd v Campbells Cash & Carry Pty Ltd* [2005] NSWCA 83, *Project 28 Pty Ltd (formerly Narui Gold Coast Pty Ltd) v Barr* [2005] NSWCA 240; *Volpes v Permanent Custodians Ltd* [2005] NSWSC 827, *Spatialinfo Pty Ltd v Telstra Corporation Ltd* [2005] FCA 455.

¹⁷ See *Project 28 Pty Ltd (Formerly Narui Gold Coast Pty Ltd) v Barr* [2005] NSWCA 240.

¹⁸ *Anstella Nominees Pty Ltd v St George Motor Finance Ltd* [2003] FCA 466.

¹⁹ *Ibid.*

²⁰ Considered by Mansfield J in *Re Addstone* (1998) 16 ACLC 1320, 1329 and 1330, and by Drummond J in *Re Movitor Pty Ltd* (1996) 14 ACLC 587. Also a factor in the decision in *Anstella Nominees Pty Ltd v St George Motor Finance Ltd* [2003] FCA 466 [7].

²¹ *Magic Menu Systems Pty Limited v AFA Facilitation Pty Limited* (1997) 72 FCR 261.

Issue 4: If so, should this be in the form of either or both:

* a list of relevant criteria for courts to consider when a funding arrangement is challenged?

* a set of legislatively required terms and disclosure requirements?

Or should this be in some other form?

Increasing transparency

Currently, liquidators are obliged to obtain court approval for litigation funding contracts, if the matter may be resolved more than 3 months after the agreement is entered into.²² This means that effectively all litigation funding agreements made by liquidators are vetted by the courts. If transparency as to the content and terms of funding contracts were similarly increased in the non-insolvency sphere, this would allow better oversight of funding arrangements. Greater transparency might also lead to improved competition in the legal services and litigation funding markets, perhaps resulting in lower pricing.

It should be borne in mind, however, that courts sanction contracts between liquidators and LFCs in order to assist creditors to receive recompense from the sale of company assets. In this instance, a clear policy rationale exists for using public resources – those of the court – to approve contracts intended to provide some compensation to the victims of company insolvency. The policy rationale for utilising court resources to authorise LFC contracts made in relation to non-insolvency matters is less clear.

To protect consumers contracting with LFCs from oppression, it may be desirable to impose probity requirements on contracting LFCs. Legislation could, for example, cap the proportion of an award that an LFC could claim and require disclosure of all obligations or liabilities imposed on a consumer in a contract.

Issue 5: Should disclosure and other requirements be imposed on LFCs when they enter into non-insolvency funding agreements?

Issue 6: If so, what should the requirements be?

Financial risk

Under standard agreements with LFCs, plaintiffs are indemnified against adverse outcomes. They therefore run only one financial risk – that the LFC will not be able to cover the legal fees or the defendant's costs in the event of an adverse order.

Issue 7: Should LFCs be subject to prudential regulation?

²² *Corporations Act 2001* (Cth) s 477(2B).

Disclosure requirements

Plaintiff agreements with LFCs could be subject to mandatory minimum disclosure requirements, like those imposed on solicitor-client costs agreements. This would improve transparency, increase certainty and reduce challenges to funded matters.

Disclosure requirements could extend beyond questions of financial risk, to cover matters such as arrangements between the LFC and the lawyers.

Issue 8: Should LFCs be subject to mandatory disclosure requirements?

Independence of lawyers from LFCs

In theory, subject to prudential regulation and s 47 of the *Trade Practices Act 1974* (Cth), a law firm could establish an associated funding company that directs LFC business to that law firm. If the firm owned the LFC it would earn legal fees as well as benefiting from the funder's capacity to bargain for a percentage of the remaining award – thus in effect circumventing any prohibitions on contingent fees, and getting paid twice for the same work.

Meanwhile, in one case²³ an LFC had agreed to pay a success fee to the solicitor in the funded matter. Because funders bear the risk in the case and pay the solicitors for their legal work irrespective of the outcome, the court found that the agreement for an uplift fee created a conflict of interest between the solicitor and the plaintiffs. The solicitor's advice to the plaintiff as to whether or not the case should proceed would not be impartial as it would be in the solicitor's interest for it to be pursued, even where there were negligible chances of winning, on the off-chance of a successful outcome. The case was stayed until arrangements were varied.

That case has made clear that it is inappropriate for lawyers to contract for uplift fees from LFCs in funded matters, and to date there is no evidence of any proprietary or financial relationships between any law firms and LFCs. But given the importance of lawyers' independence from LFCs in ensuring properly informed decisions by plaintiffs, it may be that explicit measures to this effect should be introduced.

Issue 9: Should explicit measures to ensure independence of lawyers from LFCs be introduced?

Issue 10: Should these be in the form of

- * prohibitions on certain dealings between LFCs and lawyers?
- * standard terms in contracts between LFCs, lawyers and plaintiffs?

Or some other form?

²³ *Clairs Keely (A firm) v Treacy* [2003] WASCA 229 (3 December 2003) [171].

3.3 Not-for-profit litigation funding

Currently, litigation funding operates mainly in the insolvency sphere, and for commercial or other large claims.

Given Legal Aid is generally not available for civil actions, and given the cost and risks of mounting claims, it may be desirable to ensure that further not-for-profit litigation funding services are not discouraged. This would allow access to justice for smaller cases.

For example, since 1992 the South Australian Law Society has run a not-for-profit scheme which funds civil litigation for successful applicants, in return for 15% of the value of any award if the litigation is successful. If the assisted person's claim is unsuccessful, their solicitor will be paid solicitor/client costs by the Fund. The Fund does not pay party/party costs awarded against the assisted person.

In Victoria, the Law Institute provides a similar service called Law Aid. For, eligible civil claims, Law Aid pays all the disbursements, and the solicitor and counsel work on a no-win no-fee basis. If the case is successful, the plaintiff pays for the legal work, all disbursements, and a percentage of the verdict or settlement (usually 5%), plus an administration fee. If the case is unsuccessful, the plaintiff pays only the administration fee of \$100.

Similarly, the Northern Territory Legal Aid Commission operates a fund that pays for plaintiff disbursements.

Issue 11: What measures should be taken to encourage more organisations to provide not-for-profit litigation funding?

Issue 12: Do not-for-profit litigation funding schemes operate other than the schemes described above?

Issue 13: If other not-for-profit schemes are operating, how do they work, and are any statistics available to demonstrate their effectiveness?

3.4 Insurance

An important aspect of the service provided by litigation funders is the indemnity for adverse costs orders. This kind of insurance product is offered by some insurers, independently of funding for plaintiff's investigation and legal costs.

Legal expenses insurance (LEI) provides funding for legal services directly to the client, in exchange for a policy payment. Most policies exclude cover for pre-existing matters, defamation, conveyancing, family law and serious criminal matters.

'LEI has been well established overseas for many years. In Europe, policies cover a limited range of legal matters, and are generally sold to individuals. In the United States, schemes usually provide for pre paid legal expenses, offering protection for routine and predictable legal costs for groups of policy holders, often union members.'²⁴

²⁴ Law Foundation of NSW *Legal expense insurance -- an experiment in access to justice* Law Foundation of NSW September 1999, 1.

A barrier to LEI in Australia has been the uncertainty over legal costs. The success of European LEI schemes, such as those in Germany, has been linked to their more predictable, fixed litigation costs.²⁵ ...

A further challenge for providers of LEI in Australia has been the marketing of the product. A survey conducted by the Law Council in 1986 showed that, for most of the people surveyed, LEI had little or no appeal.²⁶ The Law Foundation report concluded that if LEI is to enhance access to justice for low to middle-income earners, it must provide a broad, general coverage at an affordable cost, and remain commercially viable. Commercial viability requires bulk savings and risk spreading²⁷ .²⁸

Another litigation insurance product is 'after-the-event insurance' because it covers adverse costs orders in matters where a cause of action has already arisen. For example, in the UK there are insurance products designed for standard commercial litigation. These may cover opponents' legal fees, own legal fees, or disbursements, for plaintiffs and for defendants. The premium is often 20-40% of the total legal charges protected against. The usual basis of the policies is that payment is made if the insured fails completely with their case. The *Access to Justice Act 1999* (UK) allows courts to include the premium in a costs order.

An example of this kind of insurance is explained on the Wragge & Co website as follows.

We recently assisted a client to obtain insurance on £1million of estimated legal costs (for both parties combined) in a breach of warranty/misrepresentation dispute arising out of a corporate transaction. Happily for the client, the claim settled on the eve of the trial and our client recovered its costs as part of the settlement. Had it not, in this instance:

Our client had paid a premium of £250,000 up front, and we were able to obtain insurance for the premium itself for a further £60,000.

Had our client gone on to win, the costs would be payable by the other side on the usual basis, but the defendant would also have been liable to reimburse the insurance premium of £250,000.

Had our client lost, the insurance policy would have picked up the costs to the £1 million limit of indemnity and our client would have claimed back the initial premium paid, bearing just the £60,000.

In short, our client secured £1 million of costs cover for a ring-fenced cost of £60,000.²⁹

There are also specialist products for complex disputes (eg. one company offers up to £1.5m cover, designed for complex commercial disputes.)

²⁵ N Rickman and A Gray 'Access to the market for legal services' in A Zuckerman and R Cranston (eds) *Reform of civil procedure: Essays on 'Access to justice'* 1995, 320.

²⁶ They did not perceive themselves to be vulnerable to situations where legal costs would be incurred, Law Foundation Report, above n 24, 30.

²⁷ Ibid, ix.

²⁸ Australian Law Reform Commission, *Managing Justice: A Review of the Federal Civil Justice System*, Report 89, 1999, [5.27-5.31].

²⁹ Wragge & Co, Litigation Funding/Insurance

<http://www.wragge.com/legaladvice/disputes/international_1544.html> (accessed 14 December 2005).

After-the-event litigation insurance is available in Australia for some family law disputes.

Issue 14: Are litigation insurance products desirable in Australia?

Issue 15: If so, what steps should be taken to ensure that the availability of litigation insurance in Australia is not discouraged or prevented?

Appendix 1: Structure of a typical insolvency-litigation funding arrangement

- (a) the insolvency practitioner and company enter into a loan or other facility agreement with the LFC to advance funds to a particular limit;
- (b) the funds advanced to the company must be used for certain stated purposes;
- (c) the funds advanced, plus interest, are required to be repaid by the borrowers when the litigation is resolved;
- (d) an insurance policy is taken out with the insurer (in the name of the company and the insolvency practitioner) which indemnifies them in the event that the litigation is unsuccessful and they are unable to repay amounts owed under the loan agreement and/or unable to meet the defendant's costs;
- (e) the company pays the insurance company a premium for the insurance policy at the outset, usually funded from the first advance made by the financier under the loan arrangement;
- (f) sometimes the financier also takes a charge over the proceeds of the action and the insurance policy as security for amounts owing under the loan agreement;
- (g) if there is an existing secured creditor, a deed of priority may also be required so that the financier's charge takes priority over any other existing charge over the company's assets.³⁰

In some agreements, the funder will also provide a bank guarantee that the plaintiff's costs will be covered, so as to avoid an application for security for costs.

Some agreements allow the practitioner to select their own lawyer, others restrict the practitioner to select from a panel appointed by the funder.

Most funding agreements leave control firmly in the hands of the insolvency practitioner – who has a fiduciary duty to the creditors and so cannot give up control of the matter. In the case of a compulsory liquidation, the liquidator is also an officer of the court. Therefore, there is rarely any question of undue interference in the litigation by the funder³¹.

Because the funding agreements would risk being found void and so unenforceable if they were to give too much power to the funder, both funders and insolvency practitioners are very careful to tailor their agreements to the criteria for validity laid out by courts. These include

- if the claim would not be pursued in the absence of litigation funding
- if there is no detriment to creditors by pursuing the claim because none of the assets of the company are being used to fund it & there is a benefit to creditors if the claim is successful

³⁰ Tania Cini, 'Litigation Funding Arrangements in Corporate Insolvencies' 6 *Insolvency Law Journal* 171, 175.

³¹ Peter Britten-Jones, 'A Public Policy Approach to Litigation Funding' 8 *Insolvency Law Journal* 70, 84.

- if the creditors' approval for the agreement has been obtained³²
- if the liquidator has obtained a legal opinion to the effect that there is no indication that the claim should not be pursued³³
- if 'costs recoverable' under the arrangement include the premium³⁴
- if the liquidator has been indemnified against the opponent³⁵
- if the funder/insurer has limited rights to interfere in proceedings³⁶
- if the liquidator maintains control over settlement proposals³⁷
- where premium/profit ratio is not too high³⁸

³² *Anstella Nominees Pty Ltd v St George Motor Finance Ltd* [2003] FCA 466.

³³ *Anstella Nominees Pty Ltd v St George Motor Finance Ltd* [2003] FCA 466.

³⁴ This factor and those above were laid out by Mansfield J in *Re Addstone* (1998) 16 ACLC 1320, 1329, 1330.

³⁵ Drummond J in *Re Movitor Pty Ltd* (1996) 14 ACLC 587

³⁶ Considered by Mansfield J in *Re Addstone* (1998) 16 ACLC 1320, 1329 and 1330, and by Drummond J in *Re Movitor Pty Ltd* (1996) 14 ACLC 587. Also a factor in the decision in *Anstella Nominees Pty Ltd v St George Motor Finance Ltd* [2003] FCA 466 [7].

³⁷ *Magic Menu Systems Pty Limited v AFA Facilitation Pty Limited* (1997) 72 FCR 261.

³⁸ Considered by Mansfield J in *Re Addstone* (1998) 16 ACLC 1320, 1329 and 1330, by Drummond J in *Re Movitor Pty Ltd* (1996) 14 ACLC 587; and in *Anstella Nominees Pty Ltd v St George Motor Finance Ltd* [2003] FCA 466.

Appendix 2: Summary of issues

Issue 1: Should laws against maintenance and champerty be repealed in those jurisdictions where the tort or crime continues to exist (Western Australia, Queensland, Tasmania and the Northern Territory)?

Issue 2: Should a direct contractual agreement between the solicitor and the plaintiff be required in all funded actions?

Issue 3: Should the criteria for legally acceptable funding agreements be formalised?

Issue 4: If so, should this be in the form of either or both:

- * a list of relevant criteria?

- * a set of required terms or disclosure requirements in the agreement?

Or should this be in some other form?

Issue 5: Should disclosure and other requirements be imposed on LFCs when they enter into non-insolvency funding agreements?

Issue 6: If so, what should the requirements be?

Issue 7: Should LFCs be subject to prudential regulation?

Issue 8: Should LFCs be subject to mandatory disclosure requirements? Issue 9: Should explicit measures to ensure independence of lawyers from LFCs be introduced?

Issue 10: Should these be in the form of

- * prohibitions on certain dealings between LFCs and lawyers?

- * standard terms in contracts between LFCs, lawyers and plaintiffs?

Or some other form?

Issue 11: What measures should be taken to encourage more organisations to provide not-for-profit litigation funding?

Issue 12: Do not-for-profit litigation funding schemes operate other than the schemes described above?

Issue 13: If other not-for-profit schemes are operating, how do they work, and are any statistics available to demonstrate their effectiveness?

Issue 14: Are litigation insurance products desirable in Australia?

Issue 15: If so, what steps should be taken to ensure that the availability of litigation insurance in Australia is not discouraged or prevented?