

ETHICAL ISSUES IN LITIGATION FUNDING

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12 November 2008

A Introduction

Litigation funding involves a specialist commercial funder agreeing to meet some or all of the costs and liabilities of a piece of litigation in return for a share of any proceeds from that litigation and reimbursement of its costs. It has become an established feature of the civil justice system in many countries, including the United States, Canada, the United Kingdom, Germany, South Africa and Australia.³ Its importance, as a means of affording access to justice for individuals and businesses who are otherwise unable or unwilling to shoulder the financial burdens and risks of litigation, is well recognised. Private litigation funding occupies a key place in the range of options available to claimants to fund their claims. These include contingent and conditional legal fees, before and after the event insurance and (the increasingly scarce) publicly-funded legal aid.⁴

Third party litigation funding is a relatively recent development. It excites controversy. Historically the common law condemned litigation funding as illegal. This was because it offended the medieval doctrines of “maintenance” and “champerty.”⁵ The former outlaws any “officious intermeddling” in a law suit by a party with no legitimate interest in the subject of the suit. Champerty is an even more odious species of maintenance in which the

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² Claims Funding International plc (“CFI”) is a third party litigation funder based in the Republic of Ireland which specialises in the funding of large scale multi-party litigation in Europe and elsewhere. The views (and certainly any errors) expressed in this paper are those of the author alone and do not necessarily represent the views of CFI or of any other person or organisation associated with CFI. The author thanks Elizabeth O’Shea of CFI for her invaluable assistance in the preparation of this paper, John Walker of IMF (Australia) Limited for the provision of articles and background material referred to in this paper and Professor Laurel Terry, Penn State Dickinson School of Law (Carlisle, Pennsylvania) for articles on US litigation funding.

³ This paper discusses commercial or for-profit third party litigation funding in the non-insolvency context only and with reference to the form of funding common in Australia and the United Kingdom as described in the opening sentence of the paper. Typically such funders seek a share in the range of 15% to 50% (the median figure is around a third) of the damages or settlement depending on the costs and risks involved in funding the case. In the United States it is common for the funder to assist with the costs of the plaintiff’s own living expenses in addition or alternatively to meeting the legal costs of the action: D R Richmond, *Other People’s Money: The Ethics of Litigation Funding*, 56 Mercer L Rev 649 (2005).

⁴ For the background to the curtailment of legal aid for damages claims in the UK and the concomitant introduction of conditional fee agreements in that country, under which solicitors can undertake litigation on a no win no fee basis and have a risk-assessed uplift on their fees of up to 100% in the event of success, see A Walters and J Peysner, *Event-triggered Financing of Civil Claims: Lawyers, Insurers and the Common Law*, 8(1) Nottingham LJ 1-22 (1999).

⁵ J Morgan QC, *Third Party Funding – Legal Aspects*, a paper presented to the London Common Law and Commercial Bar Association on 12 March 2008, 2.

maintainer agrees to divide the spoils of the litigation with the party being maintained. The prohibition was strict: as originally conceived maintenance and champerty were crimes, could found actions for damages in tort (at the suit of the defendant) and any litigation funding contract in breach of them was void.

Maintenance and champerty were designed to prevent powerful men from misusing the courts by financing civil disputes in which they had no legitimate interest solely for the purpose of harassing and ruining their rivals or enemies. At a time when the powers of the courts were too weak to control such abuses, the Judges imposed a blanket prohibition to foreclose the problem.

Judicial attitudes towards maintenance and champerty are now more relaxed as courts recognise that the evils sought to be controlled by the doctrines have become extinct or are adequately addressed in other ways (this is discussed further below).⁶ Most jurisdictions have abolished, by statute, the criminal and tortious consequences of the doctrines.⁷ Many commentators regard maintenance and champerty today as largely anachronistic and obsolete and, conversely, policymakers in many countries express support for the continued development of litigation funding.⁸

But maintenance and champerty are not dead just yet. Courts can still invalidate a third party funding contract on the grounds that the contract is champertous and hence contrary to public policy and can stay the funded proceedings as an abuse of process. Some Judges remain wary of the involvement of litigation funders and strong objections to litigation funding, which carry more than an echo of the ancient abhorrence with champerty, are still heard. The courts and regulators also fear that litigation funding may lead to undesirable “trafficking” in litigation, the misuse or overuse of court resources, the exploitation of vulnerable litigants, the exposure of defendants to unfair risks and the creation of unacceptable conflicts of interest and ethical dilemmas for the lawyers who are paid by funders.

This paper argues that there is little to fear and much to be gained from the continued expansion of third party funding. Litigation funding does raise a number of interesting ethical and policy issues some of which are yet to be conclusively determined. This is hardly surprising given its recent advent. But many, if not all, of the ethical dilemmas seemingly posed by litigation funding are on closer examination more apparent than real. Policymakers are right to recognise the increasingly important and beneficial role litigation funding plays in

⁶ See, for example, the comments of Mason P in *Fostif Pty Limited v Campbells Cash and Carry Pty Limited* [2005] NSWCA 83 at [91]: “The considerations of public policy which once found maintenance and champerty so repugnant have changed over the course of time. The social utility of assisted litigation is now recognised and the provision of legal and financial assistance viewed favourably as a means of increasing access to justice.”

⁷ See, for example, in those Australian states and territories which have enacted such legislation: *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.

⁸ See, for example, the UK’s Civil Justice Council’s *Improved Access to Justice – Funding Options and Proportionate Costs – A Series of Recommendations to the Lord Chancellor to Improve Access to Justice through the Development of Improved Funding Structures* (June 2007). Recommendation 3 reads: “Properly regulated Third Party Funding should be recognised as an acceptable option for mainstream litigation. Rules of Court should also be developed to ensure effective controls over the conduct of litigation where third parties provide the funding.”

providing access to justice in modern societies and they should continue their efforts to facilitate the principled development of the industry.

B The *Fostif* Decision

The tensions which exist between the proponents and the critics of litigation funding are well illustrated in the High Court of Australia's seminal 2006 decision in the *Fostif* case.⁹ *Fostif* confirmed, by a 5:2 majority, that it is not contrary to public policy under Australian law for a funder to finance *and control* litigation in the expectation of profit and that litigation funded on this basis does not amount to an abuse of the court's process. The minority in the High Court, on the other hand, trenchantly criticised the funding arrangement.

Fostif concerned a series of opt-in representative proceedings which were funded by a firm of accountants called Firmstones. The claimants were numerous small tobacco retailers in New South Wales. They were suing for a refund of licence fees they had paid to the defendant tobacco wholesalers. The licence fees, which were in the nature of a state tax, had been declared invalid by an earlier decision of the High Court. As a result, the wholesalers were not required to remit fees paid by the retailers to the state government, but they were not inclined to refund them either. The wholesalers would enjoy a windfall if they held on to the fees, whereas the claim if successful would be a windfall for the retailers as they had passed on the cost of the licence fees to their customers. This did not invalidate their claim, however. Each individual claim was small (an average of \$1,000 or so) and hence uneconomic to bring on its own.

The case came before the High Court (Australia's most senior court) on two questions: (a) had the representative proceedings been validly constituted under the relevant rules of the New South Wales Supreme Court, and (b) were the proceedings an abuse of process and should be permanently stayed because of their manner of funding? The High Court, by a majority, held that the proceedings had *not* been validly commenced. That was enough to dispose of the appeal. However, the Court went further and by a differently constituted majority held that the funding arrangements were neither contrary to public policy nor an abuse of the court's process.

The Litigation Funding Arrangements

This was a very significant decision, which boosted the fortunes of Australia's litigation funders. The funding agreement at issue in *Fostif* conferred significant powers on the funder, yet it was upheld. In particular, Firmstones:

- Sought out the claimants through an extensive advertising and direct marketing campaign and organised the claimants into the proceedings;
- Retained the solicitor to act for the claimants and forbid the solicitor from directly liaising with the claimants;
- Gave all instructions to the solicitor in relation to the conduct of the proceedings;

⁹ *Campbells Cash and Carry Pty Limited v Fostif Pty Limited* [2006] HCA 41; Gleeson CJ, Gummow, Hayne, Crennan, Kirby, Callinan and Heydon JJ (*Fostif*).

- Had the power to settle the claims with the defendants (provided the amount of the settlement was not less than 75% of the amount claimed);
- Would receive up to 33.3% of any amounts recovered by the claimants; and
- Would retain any amounts awarded to the claimants for costs.

In return, Firmstones:

- Undertook the significant administrative task of identifying and organising the claimants;
- Agreed to meet all the legal costs and disbursements of the proceedings (the proceedings ended up in a three day hearing at first instance, a two day hearing in the NSW Court of Appeal and were ultimately lost in the High Court);
- Indemnified the claimants against all adverse costs orders (Australia has the “English” cost shifting rule which requires the loser to pay the winner’s costs in any litigation); and
- Provided security for the defendants’ costs in the sum of \$1 million.

The Minority Decision

The Judges who were in the minority on the abuse of process issue, Callinan and Heydon JJ, were scathing in their criticism of Firmstone’s arrangements, which their Honours saw as motivated purely by profit:¹⁰

The purpose of court proceedings is not to provide a means for third parties to make money by creating, multiplying and stirring up disputes in which those third parties are not involved and which would not otherwise have flared into active controversy but for the efforts of the third parties, by instituting proceedings purportedly to resolve those disputes, by assuming near total control of their conduct, and by manipulating the procedures and orders of the court with the motive, not of resolving the disputes justly, but of making very large profits.

Courts are designed to resolve a controversy between two parties who are before the court, dealing directly with each other and with the court: the resolution of a controversy between a party and a non-party is alien to this role. Further, public confidence in, and public perceptions of, the integrity of the legal system are damaged by litigation in which causes of action are treated merely as items to be dealt with commercially.

The Majority Decision

The majority Judges (Gleeson CJ, Gummow, Hayne, Crennan and Kirby JJ) took a very different view. Gummow, Hayne and Crennan JJ in a joint judgment said:¹¹

¹⁰ *Fostif* at [266] per Callinan and Heydon JJ.

¹¹ *Fostif* at [88]-[89] per Gummow, Hayne, Crennan JJ.

Shorn of the terms of disapprobation, the appellants' submissions can be seen to fasten upon Firmstones' seeking out those who may have claims, and offering terms which not only gave Firmstones control of the litigation but also would yield, so Firmstones hoped and expected, a significant profit to Firmstones. But none of these elements, alone or in combination, warrant condemnation as being contrary to public policy or leading to any abuse of process.

As Mason P rightly pointed out in the Court of Appeal, many people seek profit from assisting the processes of litigation. That a person who hazards funds in litigation wishes to control the litigation is hardly surprising. That someone seeks out those who may have a claim and excites litigation where otherwise there would be none could be condemned as contrary to public policy only if a general rule against the maintenance of actions were to be adopted. But that approach has long since been abandoned . . . And if the conduct is neither criminal nor tortious, what would be the ultimate foundation for a conclusion not only that maintaining an action (or maintaining an action in return for a share of the proceeds) should be considered as contrary to public policy, but also that the claim that is maintained should not be determined by the court whose jurisdiction otherwise is regularly invoked?

Their Honours went on to consider two fears associated with litigation funding: fears about possible adverse effects on the litigation process and fears about the fairness of the bargain struck between the funder and the client. They concluded that: "To meet these fears by adopting a rule in either form would take too broad an axe to the problems that may be seen to lie behind the fears".¹²

They rejected a role for the courts in assessing whether a funding agreement was "fair" as this assumed, wrongly, that "there is some ascertainable objective standard against which fairness is to be measured and that the courts should exercise some (unidentified) power to relieve persons of full age and capacity from bargains otherwise untainted by infirmity."¹³ And in response to Lord Denning MR's oft-repeated warning in *In re Trepca Mines Ltd (No 2)*¹⁴ that the "common law fears that the champertous maintainer might be tempted, for his own personal gain, to inflame damages, to suppress evidence, or even to suborn witnesses", the majority replied:¹⁵

Why is that fear not sufficiently addressed by existing doctrines of abuse of process and other procedural and substantive elements of the court's processes? And 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.

¹² Ibid at [91].

¹³ Ibid at [92].

¹⁴ [1963] Ch 199 at 219-220.

¹⁵ *Fostif* at [93] per Gummow, Hayne, Crennan JJ.

The majority recognised the practical reality of multi-party litigation and the positive role that funding can play in this regard. Underpinning their judgment was a determination to ensure that the defendants were not able to take advantage of “some general rule of public policy that a defendant may invoke to prevent determination of the claims that are made against the defendant.”¹⁶

Justice Kirby, in his judgment concurring with Gummow, Hayne and Crennan JJ on the abuse of process question, followed through this reasoning to its logical conclusion. He candidly observed that:

To lawyers raised in the era before such multiple claims, representative actions and litigation funding, such fees and conditions [as are found in the Firmstone funding agreement] may seem unconventional or horrible. However, when compared with the conditions approved by experienced judges in knowledgeable courts in comparable circumstances, they are not at all unusual. Furthermore, the alternative is that very many persons, with distinctly arguable legal claims, repeatedly vindicated in other like cases, are unable to recover upon those claims in accordance with their legal rights.”¹⁷

The fundamental public policy on which the majority opinion rests in *Fostif* is that of ensuring access to justice. Kirby J noted: “The importance of access to justice, as a fundamental human right which ought to be readily available to all, is clearly a new consideration that stimulates fresh thinking about representative or ‘grouped’ proceedings.”¹⁸ Further, Kirby J rejected the notion that the funder created a controversy where none had existed:¹⁹

Controversies pre-existed the proceedings, even if all those involved in them were unaware of, or unwilling earlier to pursue, their rights. A litigation funder...does not invent the rights. It merely organises those asserting such rights so that they can secure access to a court of justice that will rule on their entitlements one way or the other, according to law.

The *Fostif* decision is a robust endorsement of a “strong form” of third party litigation funding by a superior common law court. English courts are yet to go as far as the High Court, particularly on the vexed issue of the degree of control the funder may have over the proceedings, but there are unmistakable signs that they are moving towards accepting a wider role for funders.²⁰ Litigation funding agreements have been upheld in South Africa and Canada.²¹ However, even in Australia, commentators worry that post-*Fostif* “lingering

¹⁶ Ibid at [95].

¹⁷ *Fostif* at [120] per Kirby J.

¹⁸ Ibid at [145].

¹⁹ Ibid at [202].

²⁰ *Arkin v Bouchard Lines Limited (No 2)* [2005] EWCA Civ 655, [2005] 1 WLR 3055; R Mulheron and P Cashman, Third-Party Funding of Litigation: A Changing Landscape, (2008) 27 *Civil Justice Quarterly* 312-341 at 313.

²¹ See P Cashman, *Class Action Law and Practice* (Federation Press, 2007), 179-181. In relation to Canada, see P Puri, Financing of Litigation by Third-Party Investors: A Share of Justice? (1998) 36 *Osgoode Hall L J* 515-566.

uncertainties and controversies” remain about litigation funding.²² These issues are considered next.

C Ethical issues raised by litigation funding

The ethical issues raised by third party funding, many of which were examined in the *Fostif* decision, can be broadly grouped into three areas:

1. Those relating to the funder-funded litigant relationship;
2. Those relating to the due administration of justice and the proper allocation of court resources; and
3. Those relating to the tripartite relationship between the funder, the funded litigant and the lawyer retained to conduct the funded litigation.

The Funder-Client Relationship

A number of concerns have been expressed under this heading, including that:

- (a) Unscrupulous funders may take advantage of vulnerable litigants by imposing unfair or extortionate terms on them in funding agreements, misleading them about the risks or the disadvantages of the litigation or failing to fully disclose to them all relevant aspects of the funding arrangements;²³
- (b) Conflicts of interest may arise between the funder and the funded litigant which may lead to the litigant’s legitimate interests being subordinated to those of the funder or being ignored altogether (e.g. the funder forces an early and cheap settlement on the litigant in order to improve the funder’s cash flow or the litigant refuses to accept a reasonable settlement offer when the funder believes it would be prudent to do so);²⁴
- (c) The funder’s promise to meet all adverse costs orders which may be made in favour of the defendant may turn out to be illusory if the funder lacks adequate capital or insurance leaving the litigant, unexpectedly, with a very substantial liability to meet or the hapless defendant with a significant loss;²⁵ and

²² See the articles by Peta Spender, a Professor of law at the Australian National University in P Spender, *After Fostif: Lingering uncertainties and controversies about litigation funding*, (2008) 18 JJA 101 and by Associate Professor Vicki Waye of the University of Adelaide in V Waye, *Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs*, (2008) 19(1) Bond L Rev 225.

²³ Spender, *After Fostif*, above n 22, 103. See also *Litigation Funding in Australia*, Discussion Paper issued by the Standing Committee of Attorneys-General in Australia (May 2006), 8.

²⁴ V Waye, *Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs*, above n 22, 237.

²⁵ R Mulheron and P Cashman, *Third-Party Funding of Litigation*, above n 20, 317.

- (d) The funder will seek full access to all confidential and privileged documents of the litigant in order to assess the ongoing viability of the litigation but the litigant may be unwilling to provide such access.

The Justice System

Concerns litigation funding has for the due administration of justice include:

- (e) “Trafficking” in litigation, that is are funders merely stirring up disputes where none exist or encouraging people to have recourse to the courts when, absent the funder’s intervention, they would have been unlikely to have done so?²⁶
- (f) Whether the court has sufficient power to control any abuses by funders who are neither parties to the litigation nor officers of the court and whether funding arrangements have a tendency to corrupt the legal process;²⁷
- (g) Whether the court is properly informed about the existence and the terms of any funding and whether defendants are aware that the proceedings against them are being funded; and
- (h) Whether litigation funders should be regulated by bodies outside of the court system (such as national financial services regulators).

The Funder-Client-Lawyer Relationship

The tripartite funder-client-lawyer relationship has its own issues, including:

- (i) Whether the existence of litigation funding undermines performance of the lawyers’ fiduciary and professional obligations towards the funded litigant. This includes whether the lawyer can exercise sufficiently independent judgment and is able to freely advise the funded litigant including in cases where the funder’s interests may be harmed (e.g. advising the litigant not to take the funding offered).²⁸

Courts have expressed the worry that “an attorney’s primary loyalty will, as a practical matter, rest with the person or entity who pays him”²⁹ even in a case where the lawyer has a direct retainer with the funded litigant. The issues become arguably more acute where the lawyer is retained *by the funder* and not the litigant, the funder is the sole source of instructions to the lawyer (as occurred in *Fostif*) and the funder offers the prospect of repeat business for the lawyer;

²⁶ Spender, After *Fostif*, above n 22, 107.

²⁷ *Ibid*, 113, 104.

²⁸ Note comments made by Waye that where a conflict arises between the funder *as client* and the client claim holder, the primary duty is owed to the claim holder, V Waye, *Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs*, above n 22, 235.

²⁹ *Oliver v Board of Governors*, 779 SW 2d 212, 215 (Ky, 1989).

- (j) Whether the lawyer's duty of confidentiality to the funded litigant is compromised by the involvement of a litigation funder; and
- (k) Whether the funder or the litigant has the right to choose the lawyer.

D Can the Ethical Issues be Resolved?

The answer to the question posed above is emphatically "yes". This is established by a variety of mechanisms. Current practice by professional litigation funders in fact addresses many of the concerns which have been identified. The courts have, and have in fact exercised, considerable power to neutralise any threats to the justice system which might be posed by funding.³⁰ Lawyers' fiduciary duties towards the funded litigants ameliorate conflict of interest and client protection concerns. And funders themselves are either subject to regulation³¹ or, as in the United Kingdom, are actively working with policymakers and regulators in the development of an industry code of conduct.

Courts in different jurisdictions have recognised the importance of each of these factors. In this section of the paper, brief observations are made in relation to the issues identified in section C (a) to (k) above.

The Funder-Client Relationship

- (a) *Vulnerable clients:* Funding a piece of litigation in the expectation of earning a return from it is an expensive, risky and protracted undertaking. Typically the litigation will take years to resolve. The funder has outlaid very substantial sums in legal costs and disbursements during that time and has likely incurred a significant exposure to adverse costs. It is imperative, from the funder's point of view, that the litigation funding agreement is not liable to be set aside on any ground, including maintenance and champerty, misrepresentation, misleading and deceptive conduct, unconscionability, oppression or any other basis which the funder can reasonably avoid.

If the agreement was to be struck down, particularly after the proceedings have been brought to a successful conclusion, then the funder will have wasted a very considerable investment and will have forgone any hope of earning a return on that investment. It behoves funders to act with scrupulous professionalism towards the litigants they fund and to enter into funding agreements which are likely to be seen

³⁰ See for example the *Clairs Keeley* litigation in which the Full Court of the Supreme Court of Western Australia stayed funded proceedings until the funding agreement and the lawyers' retainer agreement were amended and full disclosure of the arrangements had been made to all funded litigants to the satisfaction of the Court: *Clairs Keeley (A Firm) v Treacy & Ors* [2005] WASCA 86.

³¹ In Australia, a litigation funding agreement may be subject to regulation as a derivative under section 761D of the Corporations Act 2001 (Cth) requiring the funder to hold a Financial Services Licence issued by the Australian Securities and Investments Commission. IMF (Australia) Limited, Australia's largest and only publicly listed funder, holds such a licence. The licence and associated statutory provisions impose capital adequacy, conflicts management, mandatory disclosure and dispute resolution requirements on IMF.

as fair and reasonable having regard to all the circumstances of the funding and the risks attendant in the litigation.³²

Further, many clients of litigation funders are themselves sophisticated businesses which have decided to lay off the risks of litigation by obtaining funding. They expect and receive high standards of treatment by funders. Their presence operates on a check against poor and unfair conduct towards less sophisticated litigants.

Consumer protection can be enhanced by ensuring that funders are subject to mandatory disclosure requirements, as occurs in Australia for funders holding a Financial Services Licence. Transparency is essential if a funded litigant (and any legal adviser) is to be able to make fully informed decisions about whether to enter into a litigation funding agreement.

- (b) *Conflicts of Interest:* Potential conflicts of interest between funders and funded litigants are best dealt with by ensuring that in every piece of funded litigation the lawyers who have the conduct of the proceedings owe their full professional and fiduciary duties to the litigants and that in the event of a conflict of interest between the litigants and the funder, the funding agreement expressly recognises that the lawyers may continue to act solely for the litigants even if the funder's interests are adversely affected by them doing so.³³ This standard must be observed whether the lawyer is retained by the funder or by the litigant.

A major potential area of conflict is in relation to settlements. While both funders and funded litigants have broadly the same interest in maximising any settlement or damages award and they will share the proceeds of the litigation, they can find themselves in conflict over whether or not to settle. This conflict can best be dealt with by providing that any irreconcilable difference over settlement be referred to counsel in the proceedings for a binding expert opinion.

CFI's funding agreements explicitly feature both of the safeguards referred to.

- (c) *The Funder's Financial Capacity:* A key risk for a funded litigant is that the funder lacks the resources to see the case through to conclusion and, worse, in those countries which have the English-style costs shifting rule, lacks the resources to meet any adverse costs order which might be made in favour of the defendant at the conclusion of unsuccessful proceedings.³⁴

The latter risk can be ameliorated by the court making security for costs orders (if concerns exist about the funder's financial position) which the funder must meet for

³² See also R Mulheron and P Cashman, *Third-Party Funding of Litigation*, above n 20, 316.

³³ V Waye, *Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs*, above n 22, 235.

³⁴ R Mulheron and P Cashman, *Third-Party Funding of Litigation*, above n 20, 317. Generally (but not always) litigation funders undertake to meet any costs which might be awarded to the defendant if the funded litigation fails. The defendant may be entitled to a stay of the proceedings as an abuse of process if the funder seeks to disclaim any responsibility for the defendant's costs: *Project 28 Pty Ltd (Formerly Narui Gold Coast Pty Ltd) v Barr* [2005] NSWCA 240.

the proceedings to continue. Typically funders undertake, as part of their obligations to the funded litigant, to provide any security for costs which might be ordered by the court. It is in the funder's interests to do so for if the litigant cannot provide adequate security, the proceedings will be stayed.

Funders should warn potential funded litigants of all financial risks before the litigants enter into a litigation funding agreement and either disclose their financial position to potential clients or be prepared to provide such information on request. This is an area in which some form of mandated prudential standard, either through the requirement to obtain a Financial Services Licence (as in Australia) or through adherence to an industry code of conduct with appropriate capital adequacy provisions (as is being developed in the UK), appears to be warranted.

- (d) *Confidentiality*: The funder must have complete access to all information held by the funded litigant which might be relevant to the litigation and the funder's decision to finance it. This includes information to which legal privilege attaches. Provided the litigation funding agreement makes it clear that the litigant will be required to disclose such information, and the litigant has given their informed consent to the waiver of any privilege in favour of the funder only, this should not be a concern.³⁵

The Justice System

- (e) *"Trafficking" in litigation*: A funder, acting rationally, will not fund proceedings which have poor prospects of success. This is certainly the case in jurisdictions, such as United Kingdom and Australia, which expose unsuccessful litigants and their funders to adverse costs. Funders assist the justice system by weeding out frivolous, vexatious and unmeritorious claims. For this reason there is much less risk of weak or opportunistic claims entering the civil justice system if a funder is involved.³⁶ There is also less risk that a successful defendant will not be paid its costs.

The minority in *Fostif* argued that funders nevertheless foment disputes by encouraging people to litigate who would not otherwise have done so, either because they were unaware of their injury or right to sue or because they simply chose not to sue.³⁷

In a somewhat unusual case, *Deloitte Touche Tohmatsu & Ors v JP Morgan Portfolio Services Ltd*³⁸, the Full Court of the Federal Court of Australia rejected by a 2:1 majority an appeal which raised the question of whether proceedings, which were completely controlled by a third party who funded them and *took the entire benefit of any proceeds*, were an abuse of process. The majority (Tamberlin and Jacobson JJ)

³⁵ D R Richmond, *Other People's Money: the Ethics of the Litigation Funding*, above n 3, 674-6.

³⁶ Or of any unmeritorious claims remaining in the system: invariably the funder will retain the right to terminate the funding agreement at the funder's discretion at any time or on the giving of notice. This is an essential protection for the funder in the event the litigation ceases to be meritorious or viable. In such cases, it is important (and is usually specified in the funding agreement) that the funder remains liable to meet all of its client's costs and any adverse costs incurred during the term of the funding agreement.

³⁷ *Fostif* at [274] per Callinan and Heydon JJ.

³⁸ [2007] FCAFC 52.

concluded that the funder had a genuine commercial interest in the cause of action as it was the owner of the company that held that right and that the proceedings did not tend to corrupt the court's processes.

The minority Judge, Rares J, pointed to the fact that the nominal plaintiff in the proceedings had no interest in commencing or pursuing proceedings against the defendant on its own account (it was doing so merely in discharge of a contractual obligation its parent had entered into with the funder). His Honour thought that:

The consequence of accepting that these proceedings are not an abuse of process will be that third parties can scour the community at large to investigate whether a person has an extant but unrealised cause of action and then enter into similar arrangements as in the litigation agreement [at issue in the appeal] before commencing proceedings in the person's name. Such litigation is not a use of the process of the Court to resolve a real or live controversy.³⁹

However, in many cases people genuinely want to recover their losses once they have learned of the wrong that has been done to them. Suffering a wrong is not always obvious: cartels for example are conducted in secrecy while causing enormous losses to their victims as a whole. Publicity surrounding the successful prosecution of a cartel frequently does not reach all of its victims. Losses are usually spread among a large number resulting in individual losses which are uneconomic to pursue individually.

If competition law is to be enforced and victims compensated, as (for example) the European Commission strongly advocates⁴⁰, then victims have to be informed of their rights and given an opportunity to band together to bring proceedings to recover their losses which are economically viable for the victims. Funders can play a crucial role in each aspect of this process.

³⁹ Ibid at [113].

⁴⁰ In its White Paper on Damages actions for breach of the EC antitrust rules (COM (2008) 165, 2 April 2008), the Commission of the European Communities said at 3:

The **primary objective** of this White Paper is to improve the legal conditions for victims to exercise their right under the Treaty to reparation of all damage suffered as a result of a breach of the EC antitrust rules. **Full compensation** is, therefore, the first and foremost guiding principle.

More effective compensation mechanisms mean that the costs of antitrust infringements would be borne by the infringers, and not by the victims and law-abiding businesses. Effective remedies for private parties also increase the likelihood that a greater number of illegal restrictions of competition will be detected and that infringers will be held liable. Improving compensatory justice would therefore **inherently** also produce beneficial effects in terms of **deterrence** of future infringements and greater compliance with EC antitrust rules. Safeguarding undistorted competition is an integral part of the internal market and important for implementing the Lisbon strategy. A competition culture contributes to better allocation of resources, greater economic efficiency, increased innovation and lower prices.

Further, who (outside of a court) is to say that any particular piece of otherwise perfectly valid litigation ought not to be brought? As Professor Spender observes: “pinpointing the difference between optimal litigation for socially beneficial outcomes and suboptimal trafficking in litigation is difficult.”⁴¹ It is preferable to let the court decide whether any piece of litigation is merited or not on a consideration of the facts of the individual case rather than to shut people with legitimate claims out of court altogether simply because they were organised and supported by a funder.

There is also a very practical reason why, with respect, Rares J’s concerns about funders “scouring” the land and signing up people who would otherwise be completely uninterested in bringing proceedings are misplaced. The facts in the appeal before Rares J were very unusual. The Court accepted that the “litigation agreement” in issue, which stipulated that all of the proceeds of the litigation were to be paid to the funder, was quite distinct from “an ordinary litigation funding agreement”.⁴²

No commercial funder would attempt to garner all or even most of the proceeds of the litigation for itself: apart from placing the validity of the funding agreement and the proceedings at risk, it would destroy any incentive the litigant had to pursue the claim. The litigant will, at the very least, be required to produce documents and other evidence in support of the claim and may be required to give oral evidence in court. It is essential that the litigant remains committed to seeing the litigation through. The funder needs the litigant’s full co-operation. This can only be assured if the litigant wants to pursue the claim and perceives that it has a very real stake in its successful outcome.

- (f) *Control of Abuse*: Litigation funders are usually not party to the litigation they fund and they are not subject to the disciplinary powers of the court as they are not officers of the court. However, the majority in *Fostif* had no difficulty in concluding that the courts have sufficient powers to control any abuse of process or tendency to corrupt justice that might arise from the involvement of a litigation funder in proceedings. The role played by the lawyer for the claimants is an important component of this check, as is the power of the court to award costs against funders.⁴³
- (g) *Existence of Funding*: the court can only properly exercise control over funded proceedings if it is aware of the existence of the funding in the first place. Litigation funders should be obliged to file a copy of the agreement with the court (subject to suitable confidentiality safeguards) and inform the defendant(s) that the proceedings

⁴¹ P Spender, After *Fostif* above n 22, 107. Recall also Kirby J’s comments in relation to this issue in *Fostif* at [202].

⁴² *Deloitte* [2007] FCAFC 52 at [62].

⁴³ In *Arkin v Borchard Lines Ltd & Ors* [2005] EWCA Civ 655 the Court of Appeal ordered the funder (as a non-party) to pay £1.3m as a contribution towards the costs of the successful defendants. The Court capped the funder’s liability for adverse costs at the amount it had paid in the case for its client’s own legal costs and disbursements. The Court observed at [42] that making funders liable for adverse costs means that: “Professional funders will also have to consider with even greater care whether the prospects of the litigation are sufficiently good to justify the support that they are asked to give. This also will be in the public interest.”

are being funded. Some funders will also file an undertaking with the court explicitly submitting to the court's jurisdiction in relation to adverse costs orders.

Informing the court and the other side of the existence of funding raises the risk that defendants will engage in costly and time wasting "satellite" or collateral litigation to challenge validity of the proceedings or seek disclosure of the terms of the funding. The court must be firm in discouraging such tactics. A solution might be found in the court reviewing and approving the terms of the litigation funding agreement at the outset of the proceedings. Once approved, the agreement should be immune to subsequent collateral attack by any party.

- (h) *External Regulation:* Litigation funding is not subject to industry-specific regulation anywhere in the world, so far as the writer is aware. In Australia, funders may be obliged to obtain a Financial Services Licence under the general provisions of the Corporations Act 2001. The Standing Committee of Attorneys-General, which comprises the Attorneys General of the Australian Commonwealth, States and Territories, announced in March 2008 that it would make recommendations on a preferred form of regulation for litigation funders for consideration by Ministers. This may result in the first regulatory scheme tailored to third party funders.

In the United Kingdom, the Civil Justice Council is working with the judiciary, the funding industry and regulators to develop a voluntary Code of Conduct for funders operating in the courts of England and Wales.⁴⁴ The Code is expected to address issues such as mandatory disclosure by funders to their clients, capital adequacy and complaint resolution. Litigation funders in the UK may also be subject to the claims management regulations which have been promulgated under the Compensation Act 2006.⁴⁵ These regulations, which were not drafted with third party funders in mind, may seriously curtail the identification and sign up of clients with claims in relation to financial products or services.⁴⁶ There is a need for uniform and appropriate regulation in the UK. This is being considered as part of the Civil Justice Council's work.

The introduction of appropriate regulation may assist the wider acceptance of litigation funding amongst the judiciary and the legal profession, but care will need to be taken so as not to stifle the industry through overly heavy regulation.⁴⁷ The writer does not perceive that there is any consumer-driven demand for regulation; rather the regulators consider there is a need to head off problems before they arise.

⁴⁴ N Rose, "The Code Breakers" (2008) 56 *Litigation Funding* 8.

⁴⁵ Compensation Act 2006 (c.29) (UK); Compensation (Regulated Claims Management Services) Order 2006, SI 2006/3319 and associated orders and regulations.

⁴⁶ Paragraph 4(f), Compensation (Regulated Claims Management Services) Order 2006, SI 2006/3319.

⁴⁷ The Law Council of Australia, which is the peak national representative body of the Australian legal profession, has submitted to the Standing Committee of Attorneys-General (Litigation Funding, 14 September 2006) at p 4: "The Law Council maintains its position that litigation funding is a fledgling industry in Australia, which must be allowed to develop and expand in the interests of access to justice. The Law Council believes that over-regulation will stifle the industry's growth and inhibit the competitive forces required to lower the cost of litigation funding services."

The Funder-Client-Lawyer Relationship

- (i) *The Lawyer's Ethical Duties to the Client:* The tripartite relationship between funder, client and lawyer has the potential to create numerous conflicts. This may be of particular significance in multi-party proceedings, where the claimants could be more vulnerable to both the funder taking control of the proceedings and to lawyers who fail to sufficiently protect and promote the claimants' interests above their own.⁴⁸

This includes the lawyer giving advice on the benefits and risks of the funding proposal – which might be seen to be an ethically perilous undertaking if the lawyer is financially dependant on the funder for the litigation to proceed.⁴⁹ Further, not only does the lawyer face potential conflicts between the funder's and the clients' interests, there is also a potential conflict between duties owed to *different* clients if the lawyer is retained by the funder and not directly by the litigants.⁵⁰

Subject to certain caveats noted below, the involvement of lawyers in the funder-funded party relationship surely solves more problems than it creates. The interposition of lawyers into the funding equation is central to ensuring that the interests of the funded litigant are not subordinated to those of the funder and reduces considerably the risk that the funded proceedings may tend to corrupt the justice system.⁵¹

It is in the interests of the funder that experienced and competent legal advisers act in the proceedings – the funder will have little chance of earning a return if corrupt or incompetent advisers are retained. The funder can also be expected to improve the efficiency and cost effectiveness of the lawyers through the funder's imposition of budgets on the lawyers and general experience in managing litigation and lawyers can foster the development of the funding industry and its competitiveness by advising their clients of the options available for funding litigation.⁵²

⁴⁸ V Waye, *Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs*, above n 22, 226, 270.

⁴⁹ *Ibid* 267.

⁵⁰ *Ibid* 234-5. Note Waye's comments in relation to potential conflicts for the lawyer in respect of duties to different clients – she analyses this issue on the basis that the funder is a client of the lawyer. A conflict can also arise between duties to different clients who are both (or all) claimants. For example, a conflict arises for the lawyer where one claimant is part of a "test case" and wants to settle before issues of liability are determined for the benefit of the remaining claimants.

⁵¹ Lawyers, as officers of the court, are subject to the full disciplinary power of the court over any misconduct by them in the course of the proceedings. Lawyers provide safeguards for the system of justice outside of the courtroom as well. For example, the lawyers may be required to positively certify to the court, before filing any initiating process or defence, that the lawyers consider "there are reasonable grounds for believing on the basis of provable facts and a reasonably arguable view of the law that the claim or defence (as appropriate) has reasonable prospects of success": *Legal Profession Act 2004 (NSW)*, s 347.

⁵² *The Solicitors' Code of Conduct (2007)*, Rule 2.03(d) requires solicitors in England and Wales to "discuss with the client how the client will pay [for the legal services to be provided], in particular . . . whether the client's own costs are covered by insurance or may be paid by someone else such as an employer or trade union."

As has been argued above, many conflicts of interest which are thought to be inherent in funded proceedings can be avoided or resolved by ensuring that the lawyers' fiduciary and professional duties to the litigants are given precedence over any duties or contractual obligations the lawyer may owe to the funder.⁵³ A properly drafted funding agreement will do just that.

This is so whether the funder or the funded litigant retain the lawyer. If the funder retains the lawyer, the funder generally seeks to control the proceedings (i.e. instruct the lawyers) – at least in jurisdictions where this is permitted. Provided the lawyers can still effectively discharge their duties to the funded litigants, the proceedings need not raise abuse of process or ethical concerns. That the lawyers owe duties to the funded litigants even in the absence of a direct retainer agreement with them is not doubted. An analogy has been drawn with the role of an insurer, who will take over exclusive control of litigation involving an insured:

Generally, 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 the 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 in damages will lie for breach of that duty . . .⁵⁴

Disclosure of the terms of the funding agreement to the Court (as has been suggested above) also allows the judiciary to monitor any oppressive terms and guard against any improper incursion on the lawyer-client relationship by the funder.⁵⁵ In relation to the fear that the lawyers will compromise their professional duties to the litigants in return for the hope, or even the promise, of further work from the funder, it is submitted that very few competent law firms would be willing to risk damage to, or even the destruction of, their professional reputation and business which would flow from a finding that the firm had engaged in professional misconduct or an abuse of process.

If the funder has the power to instruct the lawyers and chose to order them to take steps in breach of court orders or procedural requirements, the funder would be exposed to a contempt of court finding.⁵⁶ In multi-party cases, where the lawyers

⁵³ P Spender, *After Fostif* above n 22, 114; V Waye, *Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs*, above n 22, 235. See also Law Council of Australia, Standing Committee of Attorneys-General, *Litigation Funding* (14 September 2006), [92]: "The Law Council submits that explicit measures to ensure independence of lawyers from LFCs are unnecessary."

⁵⁴ *Project 28 Pty Ltd (Formerly Narui Gold Coast Pty Ltd) v Barr* [2005] NSWCA 240 at [70]. The Court further noted at [83], as a factor against the argument that the litigation should be stayed because the funder had absolute control over it, that the funder had nominated "a reputable firm of solicitors to act in the name of the [funded litigant] and the solicitors, in turn, have retained counsel of eminence. There is no foundation for suggesting that the solicitors and counsel would allow the case to be conducted otherwise than with entire propriety." See also *Fostif* [2005] NSWCA 83 at [87].

⁵⁵ P Spender, *After Fostif* above n 22, 114. V Waye, *Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs*, above n 22, 270-1.

⁵⁶ *Project 28*, above n 54, [94].

may face conflicting duties towards different claimants, this may be resolved by ensuring that claimants are aware, when they sign the funding agreement, that the lawyers are acting for the group as a whole.

It follows from the preceding discussion that the important role the lawyers play in funded litigation may be compromised if any of the following are missing (these are the “caveats” referred to earlier):

- (i) as noted, the lawyers’ professional and fiduciary duties towards the funded litigants must not be overridden or compromised in any way by the terms of the funding agreement;
- (ii) the lawyers must be competent, have relevant experience in the litigation being undertaken, be alive to the risk of conflicts arising and be able to give proper and objective advice to the litigants irrespective of the funder’s views including, if necessary, advising the litigants of the desirability for them to take independent advice;⁵⁷
- (iii) there must be full and accurate disclosure to all funded litigants of the terms of the lawyers’ retainer and of any other financial arrangements between the lawyers and the funder or any other party;
- (iv) the lawyers must keep the funded litigants adequately informed of all significant developments in the litigation and must inform any litigant of any matter which might adversely affect that litigant’s interests; and
- (v) the litigants themselves must retain the right to instruct the lawyers directly in relation to their own claims in the event the lawyers’ instructions come from the funder or, in a group proceeding, a committee or other representative.

A competent funder will ensure that each of these factors is provided for in the constitution and conduct of the funded proceedings. Sanctions exist if they are not met.

- (j) *The Lawyer’s Duties of Confidentiality to the Client:* There are ethical concerns associated with disclosure of confidential and privileged information by the lawyer to the funder about the client and the claim. However, as noted, there is a clear need for the funder to maintain an accurate appraisal of the litigation and funding agreements typically stipulate for full disclosure to the funder of all legal advice and documents obtained in or relating to the litigation.

Any disclosure will have to be carefully made to avoid the inadvertent waiver of lawyer-client privilege in respect of the information. The funder and client share a

⁵⁷ *Clairs Keeley (A Firm) v Treacy & Ors* [2004] WASCA 277 at [75]: “The Court can be more confident that its processes will not be abused by a litigation funder if the solicitor acting for the funded party is independent of the funder, is alive to the possibility of abuse or conflict and is fully aware of his [sic] fiduciary duties to his client.”

common interest in the litigation which generally prevents the information losing its privileged status; however it is important that the lawyer fully explains to the client any risks which might be associated with any disclosure.⁵⁸

- (k) *The Choice of Lawyer:* The UK has introduced regulations requiring legal expenses insurers only to allow insureds to choose their own lawyers.⁵⁹ Should this standard apply to a third party funder? Usually a person seeking funding will have a lawyer of their own choice working for them before the funder is approached and that lawyer will generally be acceptable to the funder.

However, in other cases where the funder is more centrally involved in identifying, informing and organising the claimants, the funder may nominate a lawyer for the litigation in the offer of funding it puts to the claimants. The claimants are free to accept such an offer or look elsewhere.

It is essential that this structure be permitted to continue. It is most likely to occur in multi-party proceedings. It is an example of a funder “value adding” to the litigation: by using its expertise and knowledge of the market (which will generally be superior to that of the litigants) to select the most appropriate lawyers and ensure that the strategic decisions they are likely to make will be sound.⁶⁰ Any other arrangement in a multi-party case would make the litigation unworkable and commercially unviable.

Indeed the Law Council of Australia, in its submission to the Standing Committee of Attorneys-General on litigation funding, specifically addressed this issue and submitted that it is reasonable for a funder to make the choice of lawyer or to veto the choice made by the claimant, particularly if the funder considers the lawyer is not up to the task.⁶¹

E Conclusion

Litigation funding has been subjected to intense judicial and regulatory scrutiny over the past 10 years or so since it emerged as an important option for claimants seeking to finance their litigation. It is gradually gaining acceptance by the courts, the legal profession, policymakers and the public around the world. The legal principles under which it operates are becoming clearer.

This paper suggests that, viewed objectively, litigation funding is a positive development for the civil justice systems in which it operates. It unarguably enhances access to justice; not for all perhaps but certainly for many with genuine claims who are currently excluded from

⁵⁸ D Richmond, *Other People’s Money*, above n 3, 675-6.

⁵⁹ The Insurance Companies (Legal Expenses Insurance) Regulations 1990 (UK), SI 1990/1159, regs 5, 6.

⁶⁰ R Mulheron and P Cashman, *Third-Party Funding of Litigation*, above n 20, 316; V Waye, *Conflicts of Interests between Claimholders, Lawyers and Litigation Entrepreneurs*, above n 22, 274.

⁶¹ Law Council of Australia, *Standing Committee of Attorneys-General, Litigation Funding* (14 September 2006), [95].

the system. And it improves the effective enforcement of the law, especially in competition and securities areas.⁶²

There is always the risk, as exists in any industry, of rogue and unprincipled players seeking to exploit unwary litigants or undermine court process for commercial gain. But having regard to the safeguards which currently exist and the proposals for appropriate regulation in certain key areas in the future (including capital adequacy of funders and mandatory disclosure of their terms of trade), litigation funding poses little risk to the integrity of the justice system and the interests of consumers. The policymakers are right to encourage its continued development.

⁶² This is materially assisted by the presence of a workable class action procedure: M J Legg, The Transformation of a Share Price Fall into Litigation – Shareholder Class Actions in Australia, paper presented at the Corporate Law Teachers Association Conference, 3-5 February 2008, Sydney, Australia.