



Centre for Socio-Legal Studies



Lincoln Law School

**INTERNATIONAL CONFERENCE ON
LITIGATION FUNDING
19 May 2010**

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Introduction to the Research Project:

These papers comprise the preliminary findings of a collaborative research project between the University of Oxford and University of Lincoln into the current status of 'third party' Litigation Funding, focussing on England and Wales.

Research Outline

The aim of the research is to examine the potential for third party litigation funding as a tool to increase access to justice and overcome some of the obstacles faced by some plaintiffs due to the high costs of litigation. The research is empirical in nature and will examine the practical, ethical and regulatory issues relating to third party litigation funding.

In addition to considering the emergence and use of third party funding in the commercial sector, the research will consider the potential for this model of funding in other areas such as group actions, international arbitration cases, and European cross border litigation. Specific questions to be considered by this research include:

1. What is the extent of third party litigation funding in England and Wales?
2. How is third party litigation funding constituted and, in particular; what contractual terms and 'cover' are used, what is the range and median of the deduction, and what is the relationship between third party funding and After the Event (ATE) insurance?
3. What is the current regulatory environment for third party litigation funding in the EU and are there different regulatory mechanisms in different jurisdictions?
4. What is the relationship between the funder and lawyer and who chooses the funder? The research will consider; whether pools of lawyers are used or how lawyers are otherwise selected, the funder's attitude towards the client's choice of lawyer, and whether the funder asks for a particular funding model to be used?

While the research is primarily focused on the emergence of and potential for third party litigation funding in England and Wales, we recognise that litigation funding is global in the sense that it exists in other jurisdictions. The research will be informed by an understanding of how litigation funding operates in other jurisdictions; specifically Australia, the USA, Canada, Ireland, Germany, Austria and the Netherlands. It will evaluate whether lessons from the United States, Canada and Australia in particular can inform the development of third party litigation funding within England and Wales.

The background to the research is the perception of a gap in access to justice linked to the difficulties of and risks inherent in pursuing litigation. Litigation funding has recently emerged as a commercial phenomenon and is clearly being used and taken up. However, it seems primarily to be relevant for commercial entities with cases of a significant size; this raises questions about any remaining access to justice issues and links with contingency fees, CFAs, legal aid or other fees arrangements. There is also an issue of the linkage with existing or future insurance for litigation costs and moves both for control of costs and to influence future policy and development. For

example, Lord Justice Jackson's December 2009 report into civil litigation costs recommends re-visiting the issue of statutory regulation of third party funders and the introduction of a voluntary code for all litigation funders. His proposed package of reforms would, if implemented, give claimants a financial interest in the level of costs which are being incurred on their behalf, and will significantly reduce the costs payable to claimant solicitors by liability insurers. This research will consider third party litigation funding in the context of possible reform of the system in England and Wales.

Project Research Team

The Research is being carried out jointly by the *Centre for Socio-Legal Studies* at the University of Oxford, the *Centre for Dispute Resolution Compensation and Risk* at the University of Lincoln. The project researchers are:

Dr Christopher Hodges –Head of the CMS Research Programme on Civil Justice Systems at the Centre for Socio-Legal Studies at the University of Oxford, and a Solicitor. He has conducted research on civil justice systems (procedural and funding systems), multi-party actions (class actions and representative/collective actions), EU regulation of products, healthcare law, product liability and consumer law. Dr Hodges is Chairman of the Pharmaceutical Services Negotiating Committee, 2007-11, has been a Board Member of the UK Research Integrity Office since 2008, a member of the Academic Advisory Panel of the Department for Business on consumer law since 2001 and a Member of the Expert Working Group of the European Commission on Directive 85/374 on product liability since 2004.

Professor John Peysner - a Solicitor and Head of the Law School at the University of Lincoln, and Honorary Visiting Professor at City University, London (2006). Professor Peysner had seventeen years experience in litigation practice, including Law Centres, Legal Aid and latterly, defending medical negligence. He has conducted research on case management, costs, civil procedural systems, legal aid, judicial education, consumer attitudes to solicitor's services and testing in house against contracted legal services. He was a member of the Lord Chancellor's Committee on Claims Assessors (The Blackwell Committee) and wrote the final draft of the report. He was a member of the Civil Justice Council and chair of its Costs Committee (2001 to 2006) a Member of the Civil Committee of the Judicial Studies Board (2003 to 2008) and an Academic Adviser to the Northern Ireland Legal Services Commission (2005).

Dr Angus Nurse - Research Fellow in Compensation Culture at Lincoln Law School investigating the myths and reality of the compensation culture and issues relating to personal injury and other compensation claims. Angus was Investigations Co-ordinator for the Royal Society for the Protection of Birds (RSPB) from 1990 to 1997 and was the RSPB's Legal & Data Protection Officer from 1997 to 2000. He was an Investigator for the Commission for Local Administration in England (the Local Government Ombudsman) from February 2000 to February 2008. His research interests include alternative dispute resolution (ADR), restorative justice, judicial review, and human rights

(free speech and regulation of fieldsports activities). Together with Professor Peysner he has also researched representative actions and restorative justice mechanisms in consumer cases for the UK Government's Department for Business Innovation and Skills (formerly the Department for Business Enterprise and Regulatory Reform).

Dr Magdalena Tulibacka – Senior Lecturer in EU and Comparative law at the University of Westminster and an Associate Fellow at the Centre for Socio-Legal Studies at the University of Oxford. She has conducted research on EU law, comparative law, civil litigation systems and European Legal culture, product liability law and consumer sales law. Dr Tulibacka's book *Product Liability Law in Transition: A Central European Perspective*, examines the evolution of Central European product liability systems, with particular reference to the effect of the implementation of the Product Liability Directive in the context of the recent enlargement of the EU. It was published by Ashgate in March 2009.

Contacts

For further information or to contact members of the research team contact:

Dr Christopher Hodges – Email – christopher.hodges@csls.ox.ac.uk

Professor John Peysner – Email – jpeysner@lincoln.ac.uk

Dr Angus Nurse – Email – anurse@lincoln.ac.uk

LIST OF ATTENDEES AT CONFERENCE ON 19 MAY 2010

Scholars

Judith Masson, University of Bristol

Dr Magdalena Tulibacka: Westminster University

Prof John Peysner and Dr Angus Nurse: University of Lincoln

Malcolm Stewart, University of Nottingham

Roderick Bagshaw, Fraser Campbell, Hafida Cheriha, Baroness Ruth Deech, Dr Deirdre Dwyer, Dr Susan Gibbons, Professor Paul Davies, Avanti Perera, Dr Wolf-Georg Ringe, Winky So: University of Oxford

Dr Chris Hodges, Dr Naomi Creutzfeldt-Banda, Dr Iris Benoehr, Sweta Chakraborty: Centre for Socio-Legal Studies, Oxford

Leonardo Raznovich, University of Kent

Judges

Lord Justice Jackson

Judge Michael Cook

Government and Regulators

Kevin Roussell and Natasha Zitcer, Ministry of Justice

Alex Roy, Legal Services Board

Steve Brooker, Legal Service Consumer Panel

Nicola Taylor, Solicitors Regulatory Authority

Bob Musgrove, Civil Justice Council

Litigation Funders and Insurance

Dr. Arndt Eversberg, Allianz Deutschland

Timothy Mayer, Allianz

Selvyn Seidel, Burford Group

Christian Stuerwald, Calunius Capital LLP

Matthew Amey, The Judge

Brain Raincock, Litigation Protection Ltd

Neil Purslow, Therium

David Lee, Oasis Legal

Julian Sale, CI Commercial Intelligence Alpha Funds

Michael Zuckerman, Benson Mazure

Jessica Mance, Thomas Miller Investment

Ray Fisher, Zurich

Consumer

Lola Bello and Joanne Milligan, Consumer Focus

Deborah prince and Michelle Lyttle, Which?

Business

Malcolm Carlisle OBE, European Justice Forum

Robert Hammesfahr and Jimi Groom, Swiss Re Services Ltd

Effa Farnsworth, GE

Thomas Spencer, GSK

William Francis, BP

Page Faulk, US Chamber of Commerce

Practitioners

Guy Mansfield QC and Gregory James, The General Council of the Bar

Maria Mas, Alvarez and Marsal

Cormac Cawley, Cormac T Cawley & Co

Maura McIntosh, Herbert Smith LLP

For information: unable to attend

John Walker and Wayne Attril, IMF Australia

Lord Daniel Brennan, Matrix Chambers

Linda Jackson and Duncan Campbell, CBI

Peter Koutsoukis, Claims Funding International plc

Dr Urs Leimbacher, Swiss Re, Zurich

Martyn Day, Leigh Day & Co

Neil Rose, journalist

Nijole Zemaitaitis, OFT

**OXFORD CONFERENCE ON LITIGATION FUNDING 19 May 2010
RUNNING ORDER**

1000 Welcome: Professor Timothy Endicott, Dean of the Law Faculty, Oxford

1600 The Litigation Funding Project and its Findings to date

1. Outline of this Conference: Dr Christopher Hodges, Head of the CMS Research Programme on Civil Justice Systems, Centre for Socio-Legal Studies, Oxford
2. Development of independent funding: different conditions and models in different legal environments:
 - a. Australia
 - b. Canada
 - c. Germany
 - d. USA
3. Access to Justice, and Funding Options in England & Wales: Professor John Peysner, Head of Lincoln Law School and Professor of Civil Justice.
4. The Oxford-Lincoln Litigation Funding Research Project: Findings of the interviews and identification of the major issues: Dr Angus Nurse, Research Fellow on Compensation Culture, Lincoln Law School

B. Discussion of the Major Issues

2. What is the public policy on dispute resolution, access to justice, and funding of litigation? Is Jackson LJ right to maximise the options?
3. What are the main funding options? In what circumstances do or should they apply? How do the various funding options compare? What advantages and disadvantages do they have?
4. As a matter of public policy, should LF be permitted, and in what circumstances and on what conditions? What are LF's advantages and disadvantages? What responses can be made to eradicate or control any problems or abuse, such as insolvency, conflicts of interest, and inappropriate behaviour? Is such response adequate to control the risk? Should there be regulation, and if so of what type(s): (a) statutory, sector self-regulation, professional/ethical, legal duties; (b) financial, legal services, insurance, other?

5. What roles and obligations should each party have – in LF or any litigation arrangement: client, lawyer, funder, insurer, other?
 - a. Investigating cases?
 - b. Collecting groups (bookbuilding)?
 - c. Information, ongoing disclosure?
 - d. Setting prices, and other terms and conditions?
 - e. Litigation management or assistance or advice?
 - f. Confidentiality, privilege?
 - g. Right to withdraw?
 - h. Transparency – fact of funding or withdrawal?
 - i. Public reporting requirements?
 - j. Choice of lawyer?
 - k. Rights to control, eg settle?
 - l. Scope for conflicts of interest?
 - m. Liability for opponents' costs?

6. What changes might occur to the funding landscape and what effects would they have? Contraction of CFA+ATE? Contingency Fees? SLAS/CLAF? Alternative Business Structures (ABS) from 2011, ie injection of private capital into law firms? Are any controls required? Will ABS lead to all litigation being funded by 'third parties', whether 'independently' or through lawyers on success fees?

7. The role of LF: commercial claims only? If LF is not for smaller consumer and SME claims, what else is?

8. Scope for potential development of LF, eg collective actions? Who would control the case, ie act as 'private attorney general' and would there be such a role in UK/EU legal systems? What risks would arise and safeguards be necessary? Is this feasible or desirable?

9. Is LF a good thing? Does the answer differ in different jurisdictions?

Timings

1115 Coffee
1245 Lunch
1345 Restart
1600 Finish

PRELIMINARY RESEARCH FINDINGS

Project Research Methodology

The research will evaluate the current use of third party litigation funding and assess the potential for it to be extended into areas beyond its current use. The research makes use of primary qualitative data, and secondary data in the form of existing documentary resources, case law and some quantitative data.

The research questions will be examined through:

1. A critical analysis of the existing literature on third party funding;
2. Collation of quantitative data on the level of third party funded cases pursued in England and Wales over the last five years (including number of cases and extent of investment);
3. An analysis of cases where third party funding has been used, primarily large cases in the commercial sector;
4. Data on the operation of third party litigation funding including; the different funding models in existence, the different contractual terms and cover employed, and detail on the running of cases.

The research will consider how insurers and third party funders currently operate third party litigation funding in England and Wales, taking into account any self-imposed barriers to the use of third party funding. It will assess how these barriers might be overcome and what more effective forms of third party funding might be developed. While the research will look primarily at large cases in the commercial sector it will also consider and develop different models for third party litigation funding.

Interviews for the research took place during April and May 2010 as follows:

- **Funders** we have thus far interviewed seven funders within the UK and received a written submission from an Australian litigation funder. All funders have been willing to talk about the types of cases they fund *although we shall retain confidentiality in any publications arising from the research and individual interviewees and their business practices/models will not be identified.*
- **Consumer and Representative Groups** interviews have been conducted with Which? and Consumer Focus. Contact has also been made with the CBI and SRA, but interview dates have not yet been confirmed. Further interviews will be undertaken by Dr Nurse and Dr Hodges after the conference.

- **Policymakers** an initial interview with the Ministry of Justice (6 May 2010) indicated that litigation funding was not a policy priority at this stage although the MOJ exhibited interest in the research and have kindly agreed to assist in follow up research into aspects of Claims Management Regulation to be carried out by Dr Nurse.

We are grateful to all those who have spoken to us thus far and welcome the opportunity to conduct further discussion of issues in contemporary third party litigation funding and its regulatory environment at the Oxford Conference. We are also happy to make contact at the conference with those wishing to participate in further interviews.

We shall present some *preliminary* empirical findings at the conference as follows:

Funding Models

This research has identified that there is no single litigation funding product. Instead litigation funding is a bespoke product in which every case is evaluated individually. There are a range of options for funding and the funding offered is evaluated according to a range of factors. However, our research has identified that there are core models for funding as follows:

- Assignment – where rights to a claim are assigned to a funder who takes over responsibility for running the claim.
- Full Funding, legal team in place, case brought to funder by lawyer.
- Variable Funding – Funder ‘active participant’.
- Brokerage of funding solutions – client has case, lawyer not necessarily in place approaches funder for options
- Lawyer Funding

The interviews and evidence that we have collated for this research have identified that the general threshold for litigation funding is £100,000 and that cases below this threshold are not viable for funding. Yet in practice a higher threshold is operated by funders with some funding cases with a claim value in excess of £1 million. The funding (and case) examples provided during interview cover a range of different funding models and types of cases but are primarily commercial cases involving corporate clients. Our analysis of the funding models discussed by litigation funders together with our analysis of the literature on litigation funding has allowed us to

develop some funding models that illustrate the different options available for litigation funding.

A - Assignment

In assignment cases, the rights to the claim are assigned to a third party who will be responsible for pursuing the claim. In this model the funder may also carry out the initial investigation of the claim and will select the lawyers, holding beauty parades, as well as having considerable input into (or even determining) the strategy for the case. The funder instructs a firm to accept the assignment and carry out the litigation.

This model has the advantage that instructions from the victim are not required, and there is freedom of choice over the jurisdiction of the claimant of litigation. However, there is a question over whether assignment of rights might amount to *barratry* which, although abolished as an offence in England and Wales in 1967, could cast doubt on whether the client's interests are being served in the handling of the case and raise concerns about the 'selling' of a claim rather than pure investment in it.

Model A is used in Australia and the US and we understand from our interviews that it has been used in cases in Europe, but we have as yet found no evidence to indicate that assignment is utilised as a funding model in the UK. The more straightforward funding model in operation is typified by Model B.

B – Full Funding, legal team in place

In this model the case is primarily brought to a litigation funder by a lawyer who has provided the client with advice on the case and made a preliminary assessment of the costs of pursuing the claim. Based on this the lawyer seeks funding to cover the likely costs and approaches a known litigation funding firm to invest in the case in return for a share of the damages.

Assuming the lawyer has carried out an appropriate assessment the litigation funder carries out an assessment based on the lawyer's preliminary advice and

the available evidence. In this model the funder's confidence in the legal team is an important factor, albeit not the sole factor. The evidence and planned legal strategy established by the legal team are also factors influencing the funding decision, meaning that funding is more likely to be obtained for a good case with an experienced legal team known to the funder or recognised as having expertise and with a clear strategy in place for the case.

Case threshold £100,000 or above - the funder may require the lawyer to take the case on a CFA basis assuming that ATE cover can be obtained. Funder may enquire into the solvency of the defendant.

Model B illustrates a relatively straightforward funding model where the funder is asked to assess the merits of the case and the existing legal strategy and to make a straight funding assessment based on a pre-existing determination of the case and its merits. The funder may require the client and legal team to clarify some aspects of the case and may offer advice on additional evidence or strategy but primarily are making an investment in the case on the basis of existing strategy. Generally funders in Model B adopt a 'hands off' approach and are purely investors in the case in return for a share of the proceeds and thus are not active participants. Model C illustrates a funding model where the funder is more involved in determining the strength of the case and in some cases the legal team, prior to agreement on funding being reached.

C – Variable Funding, Funder Active Participant

In this model the case is brought to a litigation funder either by a lawyer who has provided the client with advice on the case and made a preliminary assessment of the costs of pursuing the claim, or direct by the client (including the in-house legal department or corporate MD). The funder carries out formal investigation of the claim and may seek independent advice (e.g. Counsel's opinion) on the merits and legal strategy.

In this model, the funder may require further evidence or investigation of perceived inadequacies in the claim before offering funding and may make recommendations concerning possible strategies to be employed in pursuing a

claim.

Case threshold £100,000 or above - the funder may meet some of the costs of investigating a claim.

Model C illustrates greater involvement of the funder in assessing and investigating the claim. Although those funders we interviewed for this research were clear in indicating that with concerns about maintenance and champerty they are not involved in the running of a claim, Model C reflects the funder as a more 'active participant' in the assessment of the claim and legal strategy and a more inquisitorial due diligence process. In Model C, the client may waive legal privilege so that the funder has access to and can scrutinise the legal strategy and merits against its own independently obtained legal and expert advice and this is reflected in the funding offered and the funder's monitoring of the claim which is more 'hands on'. Model C raises issues about the management and 'supervision' of claims discussed during interviews. Model D, however, provides for an almost entirely 'hands off' approach with the funder acting solely as broker to secure funding.

D - Brokerage

In this model the client has identified a need for funding and approaches a broker for advice on the funding options. Enquiries to the litigation funder/broker in this model are made either direct by the client or from a solicitor acting on behalf of the client.

The service is essentially the same for ATE or for third party funding inquiries: the broker obtains quotes from insurers or funders and attempts to put packages together that might include funding, ATE insurance and a discounted CFA. Funding can be partial or 100% and can come from several sources, including hedge funds. The addition of ATE can reduce the level of a funder's success fee. The broker will be paid by the funder out of its commission charged. It therefore retains an interest in the outcome of the litigation, and will remain copied in on correspondence but will not be particularly active in the conduct of a case.

Where the client receives funding advice but does not have a legal team in place, it remains for them to choose an appropriate lawyer. The broker can give informal advice on appropriate law firms and may recommend several firms for the client to choose from. The funding package recommended is also likely to consist of several options for the client to consider. Funders usually require initial investigations on the evidence and merits of a claim to be completed, and an application for ATE insurance to be in train, before they will assess a proposal as a package. Funders' control is limited to the budgetary aspects rather than operational aspects, although they can seek to influence decisions.

Case threshold for brokerage for third party funding is generally £200,000 although our interviews indicate that in practice cases with a claim value under £250,000 may not be viable for brokers.

Model D involves 'pure' brokerage to determine the best funding solution where third party funding is part of a funding package rather than a single case funding solution. Our interviews indicate that brokerage is being used in pursuing group cases such as shareholder claims due to the known quantum and predictability of the claim. However one can expect the type of case funded by this type of independent funding to change and cover smaller cases and indeed our interviews reveal that a shift towards smaller cases is already discernable.

E – Lawyer Funding

In this model, funding for the claim is provided by the lawyer who is pursuing the case.

Concerns about lawyer funding include the possibility of unfair contract terms and the lack of understanding that clients may have concerning the fees they are paying. Conflict of interest is also a major issue as the lawyer occupies dual roles, funder seeking to make a return on investment in the case and legal adviser who represents the client's interests in pursuing a case.

Our research has thus far not identified widespread use of lawyer funding as a third party funding mechanism in the UK, although this is an area that we shall explore in the next stages of the research. Model E does, however, raise considerable concerns about the possibility for a conflict of interest impacting on settlement of a claim.

Our research indicates that within these models, there is considerable room for negotiation by clients with a strong case and high value claim but less room to negotiate where the client has a weaker case. In effect, the funding models currently employed by litigation funders in the UK are self-policing, weeding out bad or frivolous cases as these are not commercially viable. The models also dictate the types of cases that are suitable for different types of funding and we have also considered this issue in our research.

Provisional Conclusions

Some provisional conclusions from the research can be summarised as follows:

Access to Justice – Litigation funding has increased access to justice but only in relation to SMEs and corporate clients. The claim levels involved (e.g. in excess of £100,000) means that litigation funding is not a suitable product for smaller claims and non-corporate clients. There is thus no access to justice benefit to the general consumer or non-corporate client and the models that we have examined indicate that litigation funding would need to be developed further to provide any such product.

Capital Adequacy – While consumer groups have indicated some concern about capital adequacy and the collapse of litigation funding firms creating the possibility of consumers being left with a debt, the business model adopted by the main litigation funding firms interviewed in this research makes this unlikely. The litigation funders we have spoken to are primarily working with large funds are corporate entities rather than smaller funders and, in several cases, bring experience of litigation funding in other markets (e.g. Germany and Australia) to their UK operations, adapting a tested business model to the UK legal system. We are thus not overly concerned that there are problems with capital adequacy as litigation funding is primarily a commercial product and so funding decisions are assessed on the basis of commercial risk. However, we would have concerns should there be an expansion of litigation funding into the consumer market with smaller funders entering into the market.

Champerty and Maintenance – Fears about maintenance and Champerty expressed in some of the (mainly US) literature are unfounded on the basis of the litigation funding models being employed in the UK. Our interviews and review of the

funding models indicate that funders do not take an active role in the running of a case but primarily carry out investigation and review of a claim as a means of ensuring that their investment can be realised. The lawyer's duty to the client is preserved (see below) and the existence of a strong legal team able to effectively advise the client is desired by both funder and client.

Conflict of Interest (Lawyer-Client relationship) – Fears that protection for the consumer through erosion of the lawyer-client relationship also seem groundless. Our research identifies that confidence in the legal team and the lawyer retaining independence in their relationship with the client are integral to an assessment of the funding needs and the operation of a claim. There are concerns where lawyer funding is the mechanism used for funding cases due to the dual role of investor and client adviser/representative that lawyers have in such cases. This dual role creates considerable potential for a conflict of interest; the lawyer seeking to maximise a return on his investment could reach a different view on the merits of a settlement than the lawyer representing his client's best interest.

Consumer Protection – At present litigation funding does not raise significant consumer protection concerns as it is primarily a commercial product at SMEs (and above) rather than the general consumers. However, should consumers enter into the market there may be some concerns about the *potential* for unfair contract terms, given the lack of knowledge that some consumers have of funding arrangements, their rights in respect of the handling and management of claims and the relatively strong position that funders may hold where claimants are unable to pursue a case with their own resources. While we do not see this as an issue within the structure of the existing industry, our interviews have identified this as a possible issue should the market extend to cover smaller consumer cases and this is an issue to be explored further. However, this would seem to be a general consumer issue rather than one specific to the litigation funding industry.

Regulation – The interviews indicate that funders and consumer groups alike would welcome Government regulation of the market, although reasons for this shared view differ. From the funders' perspective, regulation will prevent 'rogue' funders from entering the market, will increase its legitimacy and could even help to grow the market. For consumer groups, self-regulation is seen as being inadequate and could lead to the larger firms unduly monopolising the market and preventing new entrants, who may offer a consumer-focused product, from being able to enter into the market. Our research has, however, indicated that there is no clear consensus on the form that such regulation should take. Some respondents believe it should be the responsibility of the Ministry of Justice in harmony with claims management regulation, some consider it should be the role of the FSA and one consumer group indicated that third party funding agreements and settlements should be subject to scrutiny by an Ombudsman. We shall explore these issues further in the next stage of our research.

Settlement Issues – Our initial research suggests that the involvement of a litigation funder may influence the settlement of a case by providing ‘notice’ that a claimant cannot be intimidated by a larger firm. Interview respondents indicated to us that many of the cases suitable for litigation funding are of a David vs. Goliath nature, where the provision of funding allows a claimant to pursue a case effectively whereas without third party funding many claims might not be pursued. Further research is needed into whether the availability of litigation funding has *encouraged* litigation but the preliminary evidence of this research does not support any such conclusion. However the involvement of a funder and resources to pursue a case effectively may be a factor in influencing settlements and discouraging larger corporations from seeking to frustrate our wear down a smaller company pursuing a claim.

While it should be noted that these are only our *provisional* conclusions we can see that the models for litigation funding that we have identified provide a means for SMEs to pursue cases that might otherwise have been abandoned due to funding issues. Not all cases will be pursued through to judgment and award of damages and it seems that litigation funders have a role to play in facilitating settlement of cases. One issue raised in our research is the use of mediation during the settlement process which can be daunting and time-consuming process for the SME involved in litigation who may also be at a disadvantage when dealing with professional mediators and larger corporations experienced in the ADR process. The involvement of litigation funders can benefit the inexperienced SME client by providing for (and funding) assistance and training in the mediation process as part of the supervision of a case as an interested party. We consider that litigation funders have an interest in increasing the efficiency of dispute resolution and court processes and improving the speed at which cases are determined whether through the court process or ADR and management and supervision issues will be explored further in the next stage of the research. We shall also consider the possibility of extending litigation funding into other areas and addressing the ‘gap’ in providing funding for smaller consumer cases.

INTRODUCTION TO LITIGATION FUNDING ISSUES

The historical controls have been:

- a. maintenance (improperly encouraging litigation)
- b. champerty (funding a third party's litigation for profit)
- c. abuse of process

PUBLIC POLICY ON LF

Importance of the national environment of the legal system.

1. Policy on 'access to justice' and the breadth of pathways.
2. Availability of funding options.
3. Policy on costs shifting rule and prohibition against lawyers charging contingency fees.

What is public policy on dispute resolution, access to justice, and funding of litigation? The following appears to be the policy for England & Wales:

1. Providing access to justice, but not at public expense.
2. Encouraging claims with good merits, but not encouraging claims with poor merits.
3. Providing a range of alternative dispute resolution pathways, with the courts as last resort, and pathways that are appropriately designed for particular disputes.
4. A one way cost shifting regime, but it needs to contain elements that deter against bringing frivolous claims or applications, and incentives for claimants to accept reasonable offers of settlement.¹
5. In order to give effect to the social policy that certain types of claimants should be protected against the risk of adverse costs,² there should be a qualified one way cost shifting rule for them,³ instead of the normal two way rule. The qualified approach enables targeting of the protection on those who need it, and gives them a stake in the outcome so as to exert some control on costs. This was the approach operated successfully under the legal aid regime.⁴ The protection should apply to cases where there is an asymmetric relationship between the parties, so it should

¹ Final Report, ch 19, para 4.5.

² And in the light of data that suggests that most personal injury claims are valid.

³ Final Report, chs 9 and 10.

⁴ Still enshrined in the Access to Justice Act 1999, s 11(1): 'Costs ordered against an individual ... shall not exceed the amount (if any) which is a reasonable one for him to pay having regard to all the circumstances including – (a) the financial resources of all parties to the proceedings and (b) their conduct in connection with the dispute...'

apply in personal injury cases and defamation cases,⁵ and there should be further consultation⁶ on application to housing disrepair, actions against the police, claimants seeking judicial review, and individuals claiming defamation or breach of privacy.

6. Acceptance that claimants can be expected to pay some costs out of their damages. Protection of personal injury claimants by a one-off rise in the level of general damages for pain and suffering and loss of amenity would be increased by 10 per cent. Secondly, the amount of success fees that lawyers may deduct would be capped at 25 per cent. For similar reasons, the general level of damages would be raised by 10 per cent for defamation and breach of privacy cases.⁷

WHAT ARE THE SOURCES OF FUNDING LITIGATION?

The possible sources of litigation finance are:

1. Own funds
2. State funds – legal aid or legal assistance
3. Shared funds: trade union
4. Own LE insurance (BTE LEI)
5. Own *post facto* LEI – ATE
6. Own lawyer – deferred payment, success fee, contingency fee
7. Third party

LEI is widespread in civil law procedure jurisdictions, exemplified by the paradigm jurisdictions of Germany and Austria, where tariffs exist for client-lawyer fees and, crucially, for shifted loser pays fees. LEI is reasonably or widely available in Denmark, England and Wales, Estonia, Finland, France, Germany (43 per cent of the population), Hungary, Ireland, Japan, the Netherlands and Spain.⁸

LF is spreading from Australia (typically with a 20-40 per cent fee) and in some European jurisdictions (Austria, Germany, Ireland, the Netherlands (where the fee can be 25-40 per cent of the recovery) and United Kingdom. The fee is not recoverable under the civil law tariff systems, so is deducted from damages. Some private funders have also existed in USA for some years, but currently appear to be expanding quickly.

US contingency fee. The American model of contingency fees goes further and includes payment of a larger element in the event of success, explicitly linked to the size of the recovery. This is argued to align the incentives of the client and the lawyer in the same direction of recovery maximisation.⁹ But it has also been criticised as

⁵ Final Report, ch 32.

⁶ Final Report, ch 30.

⁷ Final Report, ch 32.

⁸ C Hodges, S Vogenauer and M Tulibacka, *The Funding and Costs of Civil Litigation: A Comparative Perspective* (Hart Publishing, in press).

⁹ Amongst numerous sources see HM Kritzer, *The Justice Broker: Lawyers and Ordinary Litigation* (Oxford, Oxford University Press, 1990).

reducing the maximisation incentive after a certain level of investment of time because of asymmetric incentives over settlement, although empirical evidence of such practice in the United States is difficult to find.¹⁰ Kritzer has found that the type of fee arrangement is related to the type of client. A contingency fee is the arrangement of choice for individuals, whereas hourly rates or fixed fees are favoured by business clients.¹¹ A lawyer who works on a contingency fee case combines the roles of professional legal adviser, advocate, financier and insurance broker.¹² His effort is strongly influenced by how he is being paid,¹³ and he will reject cases that do not satisfy his risk-to-return criteria.¹⁴ The rejection rate of cases from potential clients appears to be around 50 per cent.¹⁵ In the long run, compensation for professional services is dependent on performance.¹⁶

COMPARISON BETWEEN DIFFERENT FUNDING SYSTEMS.

A categorisation of funding types might be as follows:

- A. Own funding
- B. External funding
 - (i) Pooled in advance: trade union, purchased insurance (liability insurance for defendants, BTE LEI for claimants)
 - (ii) Pooled for a specific transaction: legal aid, bank loan, ATE for costs risk only, LF
 - (iii) Provided by an intermediary involved in the specific transaction:
 - a. Lawyer
 - b. Funder

What issues arise with these different types?

1. Viewed as sources of finance, is there much difference between own funding and external funding? Clients may be able to fund a case from their own resources or not: should the source of the finance matter, in the sense that certain sources should not be permitted? The use of any independent sources of funding constitutes risk spreading. Is there any difference between the functions of (a) funding for a case (b) insurance for the adverse cost risk?
2. Funding sources can in any event be combined within individual cases. Co-funding is inherent in legal aid and in CFAs plus ATE insurance.

¹⁰ See A Tabarrok and E Helland, 'Two Cheers for Contingency Fees' (*The AEI Press*, 2005).

¹¹ See HM Kritzer, *Risks, Reputations, and Rewards: Contingency Fee Legal Practice in the United States* (Stanford University Press, 2004).

¹² HM Kritzer, 'The Wages of Risk: The Returns of Contingent Fee Legal Practice' (1997) 47 *De Paul L Rev* 267; HM Kritzer, *Risks, Reputations, and Rewards: Contingency Fee Legal Practice in the United States* (Stanford University Press, 2004).

¹³ See HM Kritzer, *The Justice Broker: Lawyers and Ordinary Litigation* (Oxford, Oxford University Press, 1990), 126.

¹⁴ HM Kritzer, 'Seven Dogged Myths concerning Contingency Fees' (2002) 80 *Wash U L Q* 739.

¹⁵ HM Kritzer, *Risks, Reputations, and Rewards: Contingency Fee Legal Practice in the United States* (Stanford University Press, 2004), ch 3.

¹⁶ WJ Lynk, 'The Courts and the Market' (1990) 19 *J of Legal Studies* 247.

3. From the perspective of maintaining a stable legal system, issues arise of
 - a. **The reliability of the funding source.** Insurance companies and banks are regulated in relation to maintenance of capital adequacy, reserve policy, and liquidity. Exactly the same issues arise for litigation funders and lawyer funders: there should be consistency, so as to provide both client protection and a level playing field for all providers.
 - b. **Acceptable commercial activities.** Provision of adequate, true and timely information to investors and clients; appropriate marketing and selling activities; appropriate terms; appropriate commercial behaviour.
 - c. **Acceptable behaviour within the legal process.** The public policy is that the principles of justice must be scrupulously maintained, and unaffected by any unethical or inappropriate commercial behaviour. It may even be said that the even the possibility of inappropriate interference in the judicial process is unacceptable: justice must not just be done but be seen to be done. The Jackson Review noted¹⁷ that the current English case law aims at ‘whether the agreement has a *tendency to corrupt public justice* and .. such a question requires the closest attention to the nature and surrounding circumstances of a particular agreement’¹⁸ and ‘the rules of champerty, so far as they have survived, are primarily concerned with the *protection of the integrity of the litigation process*’¹⁹ [emphasis added]. So the practical issue that arises is to insulate and protect the judicial process from inappropriate behaviour that might undermine confidence in justice and the impartiality of the judicial process.
4. In relation to issue c, the risks to the judicial system arise where there are conflicts of interest between the interests of clients, intermediaries and funders. Sensitive situations arise when a funder places improper pressure on a party or lawyer in relation to terms of the arrangement, or in relation to when to accept a settlement or at what level, or decides to withdraw support inappropriately. If a funder selects the lawyer, this may bring advantages of expertise and lower price, but might also increase potential for improper pressure. How significant is this in practice?
5. So the main potential arises where there are conflicts of interest. The questions are:
 - a. **Do certain situations give rise to conflicts that cannot be satisfactorily controlled and should be banned?** For example, where the lawyer provides *both* independent professional advice and services and funding services, this situation inevitably always raises the potential for conflict of interests. How significant are the conflicts that arise in practice? Do the conflicts that arise differ in intensity, such that in some or all situations the potential for abuse is an acceptable risk and can be controlled by other means, such as through professional ethical requirements? Is there a difference say between large commercial cases and small consumer cases? This suggests that private

¹⁷ Preliminary Report (2009) ch 15.

¹⁸ *Giles v Thompson*.

¹⁹ *Papera Traders Co Ltd v Hyundai (Merchant) Marine Co Ltd No 2* [2002] Lloyd’s Rep 692.

funding, if it is subject to adequate constraints, is preferable to lawyers' funding. Should lawyers' funding be removed – in some situations or totally – if private funding is available?

b. If there are situations in which the degree of conflict is acceptable, but should be controlled, what means of control are appropriate?

6. A conclusion is that lawyer funding gives rise to inherent conflict, whereas where the roles of adviser and funder are kept separate there is less potential for conflict. However, if the funder provides services that control the litigation, there is potential for abuse: how far should funders go in investigation and management of litigation?
7. Do we have sufficient empirical understanding of the potential for conflict to arise in lawyer funding or in third party funding to be able to answer these questions? Lawyers would assert that there are no problems in their activities, and that experience of success fees demonstrates that the risks are low. Should there not be more reliable evidence of what actually happens in practice?
8. Alignment of the interests of client and funder is in general a good thing. But can itself give rise to the risk of undesirable behaviour in litigation.
 - a. The Jackson Review criticised the recoverability of CFA success fees and ATE premiums because the regime has had unfortunate unintended consequences, namely (a) litigants with CFAs have little interest in controlling the costs which are being incurred on their behalf and (b) opposing litigants face a massively increased costs liability. The same was true of legal aid cases where claimants who were not liable to make contributions, since all legally aided claimants were effectively insulated from adverse costs orders: the result was referred to as 'legal aid blackmail' by defendants.
 - b. If the adverse cost risk is off-set, through ATE (with or without LF), the client has no risk, will this lead to inappropriate behaviour? US experience of individual cases and class actions suggests that where class members have no risk, and litigation is controlled by the lawyer-funder, issues arise over (a) conflicts and (b) what would be regarded in EU as unmeritorious and excessive litigation. But is this an issue peculiar to USA, or class actions? To what extent is the assertion about USA a myth?
9. There are several important potential changes in the environment to consider.
 - a. If the Jackson proposals of non-recoverability of CFAs and ATE elements are implemented, ATE may become more expensive and less available.
 - b. What effect will Alternative Business Structures (ABS) – injection of private capital into lawyers – have from 2011? Are any controls required? Will ABS lead to all litigation being funded by 'third parties', whether 'independently' or through lawyers on CFAs etc?
 - c. What effect would the appearance of a SLAS or CLAF onto the scene have? What degree of regulation would be needed?

IS JACKSON LJ RIGHT TO MAXIMISE THE OPTIONS FOR FUNDING CLAIMS?²⁰

1. Choice is a good thing, and induces competition, best practice and lower prices.
2. But some funding mechanisms may tend to favour particular pathways that may be inappropriate for particular disputes, or not cover some types of dispute (non-monetary claims, small claims).
3. Inevitably, some funding types are unsuitable, or less suitable, for some types of claims. So an image of the legal system in which all funding types are available for all types of claim is inaccurate. For example, LF does little for non-monetary disputes. So there needs to be an analysis of which funding mechanisms, individually or together, may be applicable to particular types of dispute and dispute resolution procedures. For example, the irrecoverability of costs for the small claims track means that funding for representation is unnecessary and not encouraged.
4. LF tends to push claims towards the courts: this may be inappropriate in some cases. Should there be a strengthened rule that the courts may only be accessed if alternative pathways are inappropriate? That rule would not prevent raising or resolution of disputes, but it would prioritise the availability of pathways.

ARGUMENTS IN FAVOUR OF LF

1. Pragmatism: unavailability of legal aid, preference for LF over lawyer funding.
2. What is the difference between funding by the individual, an insurer, the state (legal aid), the lawyer, or a third party?
3. 'the social utility of funded proceedings'²¹
4. 'inject a welcome element of commercial objectivity into the way in which [litigation] budgets are framed'²² and
5. increase the efficiency with which litigation is conducted.²³
6. potential to foster the aims of class action legislation²⁴
7. existing doctrines of abuse of process and the courts' ability to protect their processes are sufficient to deal with a funder conducting themselves in a manner 'inimical to the due administration of justice'.²⁵
8. 'In jurisdictions which had abolished maintenance and champerty as crimes and torts, ... there were no public policy questions beyond those that would be relevant when considering the enforceability of the agreement for maintenance of

²⁰ Final Report, ch 12, para 4.2.

²¹ *Fostif v Campbells Cash and Carry* [2005] 63 NSWLR 203. Upheld *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386.

²² *QPSX Limited v Ericsson Australia Pty Ltd* [2005] FCA 933, at [54].

²³ *QPSX Limited v Ericsson Australia Pty Ltd* [2005] FCA 933, at [54].

²⁴ *Kirby v Centro* [2008] FCA 1505.

²⁵ *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386 at [93]. See also *Jeffery & Katauskas Pty Limited v SST Consulting Pty Ltd* (2009) 239 CLR 75 at [26], [29]-[30].

the proceedings as between the parties to the agreement.²⁶ In other words, once the legislature abolished the crimes and the torts of maintenance, these concepts cannot be used to found a challenge to proceedings which are being maintained. Their only relevance is in a dispute between plaintiff and funder about the enforceability of the agreement.²⁷

ARGUMENTS AGAINST LF

1. The doctrinal concern that the judicial system should not be the site of speculative business ventures.
2. The prevention of abuses of court process (vexatious or oppressive litigation, elevated damages, suppressed evidence, suborned witnesses) for personal gain.
3. The risk that such behaviour will inevitably give rise to conflicts of interests between funders (whether lawyers or independents) and clients, which will result in pressure to settle cases at particular times or for particular sums that are not in the clients' best interests but are in the intermediary's commercial interests.
4. Particular concerns in collective (class) procedures, where (a) clients have little understanding or control and (b) the commercial interests of intermediaries may be very large and significantly larger than clients' individual interests.
5. LF may turn into protection rackets, where cases are filed and disappear if the defendant pays the funder or law firm.²⁸ This is linked with a fear that funders may bring large cases (individual or collective) in which the size of the commercial pressure on defendants may dwarf limited merits and force unfair settlements (blackmail).

OPERATION LF Conflicts, control and settlement

The analysis above suggests that the behaviour that has to be examined is: Who investigates a case, selects the lawyers, controls prices, instructs the lawyers, controls the strategic conduct of the case, and controls settlement.

1. Australian model: LF investigates case and instructs the lawyer (and manages its exposure on a daily basis) but the client/lawyer can override them. LF may cease funding at its discretion. Counsel's opinion to resolve differences of opinion on settlement.
2. Argument that investors may control up to 30% of the investment in a company. What is the difference, if any?

²⁶ Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd (2006) 229 CLR 386 at [84]-[86].

²⁷ M Legg, L Travers, E Park and N Turner, 'Litigation Funding in Australia' paper at the Law Society of New South Wales Young Lawyers' 2010 Annual Civil Litigation One Day Seminar, 13 March 2010.

²⁸ R Johnson at Class Action Conference, University of Sydney, December 2009.

3. Current predominant model in UK (although not universal); client selects lawyer, and funder does not give instructions to lawyer, although can voice opinions. Only ultimate sanction for funder is to withdraw, but commercial pressure would make that a rare event.
4. There is some evidence of demand for wide-ranging management services by clients, in some combination of investigation, selection of lawyer, instruction of lawyer etc. Should this be a service provided by funders, or lawyers, or by independent parties?
5. Choice of lawyer. The Directive provides that a client shall have freedom of choice of lawyer. But this is interpreted differently in different Member States. In UK, the [] Ombudsman considers that the requirement for choice arises only at the time at which proceedings are issued. That is usually some way into the funding arrangement. The result in practice is that it is not in clients' interests to change lawyers at that point. The French have interpreted the requirement to provide freedom of choice of lawyer, and this will have the effect of restricting the development of LF in their market. A major French company has recently made a 10m loss and made a reserve of a similar size because of add-ons.
6. Should funder be able to withdraw? Would this undermine the negotiating position of the plaintiff? cf Harbour's withdrawal in the Young divorce case.

Pricing

7. Is reimbursement of outlay, percentage of the Resolution Sum, and possibly a management fee fair?
8. Should there be transparency of the actuarial calculations on cost of capital and profit margin?
9. Relevance of uncertainty and risk: risk assessment of chances of success is crucial.
10. Governments or markets are imposing percentages on uplifts:
 - Australia: IMF between 20% and 40%.
 - Canada. The Ontario Class Proceedings Fund takes a premium of 10% of recoveries, and is widely used. The Canadian law firm Siskinds funds cases and a court has recently held that a 6% premium was reasonable for a recovery of C\$10m but not if it were C\$3m.
 - USA: contingency fee 30% rule of thumb? See empirical research ..
 - UK commercial funders aim for 30%.
 - Jackson Review recommends that no contingency fee deducted from damages should exceed 25% of the damages, excluding damages referable to future costs or losses.

- UK proposal that in damages-based agreements (contingency fees) in employment cases, the payment to the lawyer must not exceed 35% of the sum recovered by the client.²⁹
 - UK proposal that the CFA uplift ceiling in defamation cases should be reduced from 100% to 10% of base costs.³⁰
 - Poland limit on contingency fees in collective actions to 20%.³¹
 - Australia has significantly reduced legal aid (a reduction in expenditure since 1995-96 of 78 per cent has driven a third of providers from the market) and instead has removed the traditional common law ban on contingency fees (capped at 25 per cent) in 2006.
 - The Ontario Class Proceedings Fund takes a premium of 10% of recoveries, and is widely used. The Canadian law firm Siskinds funds cases and the court has recently held that a 6% premium was reasonable for a recovery of C\$10m but not if it were C\$3m.
11. So governments are increasingly imposing limits on percentage uplifts. Some of the regulated maximum uplifts or prices of some funds are lower than current market prices. Funders would argue that they are assuming significant risk as pioneers in unknown and risky territory, and deserve an element of premium prices.
 12. What size of uplift is appropriate? Should the market decide in commercial cases? Is the market large enough? Will it mature, how soon, and to what size? If the target clientele remains SMEs, will they have limited negotiating power? Should there be controls in consumer cases, or are existing rules on unfair contract terms or unfair commercial practices enough? What about the failure of ex post litigation over bank charges—is ex ante regulation needed?
 13. What is the actual cost of funding litigation (cost of capital) and do funders lead to lower legal costs? Should the figures be transparent? Will prices fall and calculations become more transparent as the market matures?

Regulation

1. The precedent of English claims farmers under the post-1999 CFA+ATE regime, demonstrated widespread consumer detriment and need for statutory regulation (Compensation Act 2005). The Claims Management Regulation Unit in Ministry of Justice, sub-contracts some functions to Staffordshire County Council, and works with other regulators such as the Office of Fair Trading, police services and the Insurance Fraud Bureau.
2. What functions require regulation? The central issue is to control against conflicts of interest that might affect decisions. The conflict is between the client's

²⁹ http://www.opsi.gov.uk/si/si2010/draft/pdf/ukdsi_9780111491669_en.pdf. The Draft Explanatory Memorandum is available at

http://www.opsi.gov.uk/si/si2010/draft/em/ukdsiem_9780111491669_en.pdf.

³⁰ The full text is available at <http://www.justice.gov.uk/consultations/costs-defamation-proceedings-consultation.htm>.

³¹ Act on Class Actions of 2009.

interests in autonomy and the protection of disinterested advice, against the funder's commercial interest in maximising return and limiting loss and risk. This leads to the central question, which is: who takes what decisions during the litigation, especially on (a) initiation, (b) extent of expenditure (evidence, work, appeal), (c) settlement.

3. Should regulation be through
 - a. Financial Services Regulation?
 - b. Legal Services regulation?
 - c. Consumer protection regulation?
4. Should any regulation be public or private? Should it include elements of self-regulation, either at company or industry levels?
 - Professional conduct. Would a code be enough?
 - Should TPF owe a fiduciary duty?
 - Australia seems to prefer light touch regulation, involving self-regulation. But concern over conflicts of interest for lawyers and funders in settlements.
5. In the United States, some seven states have so far introduced regulatory laws, and more are planned. These laws, however, only deal with consumer LF, not commercial LF. Bar Associations in USA are producing opinions that influence state legislation on regulatory schemes. The opinions tend to cover lawyers' duties, rather than funders' activities, but they depend on there being some certainty on what the latter are.
6. Australia seems to be heading towards light-touch regulation, with tiers of regulation: public, professional and industry self-regulatory.

Economic parameters of LF

It is uneconomic to support cases worth under £100,000 damages. In practice, most cases involve over £500,000, and most are in the range of £1 million to £50 million. This contrasts with Germany where a €100k case works well with costs of around €15k, under the predictable tariffs for lawyers' fees and recoverable costs. Any change in the English rules of procedure or cost recovery and effectiveness would affect the cost-effectiveness of investing in this jurisdiction.

To what extent is LF dependent on insurance against the adverse cost risk? Is such cover dependent on the survival of the ATE market? ATE is a bespoke product, so is more expensive than larger pools of BTE insurance: can a market develop for cheaper adverse costs risk?

Types of cases funded by LF

Cases are selected for funding based on (a) the ability to deliver a financial return and (b) their attractiveness of the return. This inevitably prioritises certain types of case, and prevents others from being funded.

The cases that are funded are mainly commercial. These include contract, competition, tort, intellectual property, construction, insolvency disputes.

The types that are not funded: Medical negligence cases are funded in Germany but no so far in UK. Small SME or consumer cases are too small to be funded: they do not provide sufficient return.

POTENTIAL DEVELOPMENT OF LF

What commercial constraints might limit the spread of LF?

Should LFs be able to provide a 'complete service' to a client? John Walker of IMF argues that many clients wish to hand all decisions over to the LF, who is in a position to provide an expert service in handling a case, and capable of taking all decisions.

Would this be a step too far from client autonomy and control over their own affairs?

LF AND COLLECTIVE ACTIONS

1. The US experience raises a sequence of issues. The primary issue is: who is the 'private attorney general'? ie who initiates and controls the enforcement action? The key question is: who is appropriate to exercise such power and who is not?
 - a. In USA it is the lawyer.
 - b. In Australia, it is the funder (since there is only a nominal class representative).
 - c. In EU it is sometimes a consumer association.
 - d. In UK financial services and consumer protection it will increasingly be a public agency, through regulatory assistance policy.
 - e. In UK consumer protection it may also be the Consumer Advocate as a last resort, rather than individuals or lawyers.
2. Conclusion: UK has adopted the policy that the 'private attorney general' role is inappropriate and that mass enforcement of private damages claims is inappropriate for private funders or persons.
3. There should be symmetry and balance between the parties. Collective procedures significantly improve the position of mass parties who each have small claims. Class action experience raises issues over whether the balance goes too far: almost every case that passes certification settles, and issues of unfair pressure to settle have been made. Empirical research on these issues is needed in order to establish the true position. But the issue here is whether litigation funders may pursue cases where the merits are less than say 50% since the sheer size of a case may provoke a settlement, and a settlement of significant size. In other words, there is a balance between merits and size, and class actions afford potential for abuse. If such abuse

might occur in USA, where private enforcement is encouraged, what is the potential for abuse in a European collective redress system?

4. The Australian experience demonstrates that an opt-in regime is inconsistent with litigation funding, and that only an opt-out lock-out is capable of working in almost any circumstances.
5. The Australian class action model in which there is a single representative plaintiff raises issues of exclusivity. Australian funding agreements typically provide that clients will not be liable for adverse costs, and that the risk is covered by the funder. Prof Cashman argues that if a representative plaintiff turns out to have a bad case and has to drop out, the lawyers assume liability for costs and are prevented from proceeding with other good cases in the class, so it would be preferable for the lawyers to have no liability for costs and not get into funding cases.

WHERE ARE THE GAPS IN ACCESS TO JUSTICE?

What alternative funding models might cover smaller claims, or non-monetary claims? CLAF? BTE? Other pooling models?

What types of claims need to have alternative pathways, eg because funding is unsustainable?

NOTE ON LITIGATION FUNDING IN AUSTRALIA³²

1. Litigation funding is a business that decides whether to fund cases based on risk and return.³³ The essential objective of a funder is to secure a return on investment. In this respect, the financial objectives of persons funded and of funder are aligned.³⁴
2. LF is well-established in Australia.
 - d. There are around seven commercial funders.³⁵ The largest, IMF [listed in 2001] and Hillcrest Litigation Services Limited, are listed on the Australian Securities Exchange. Listing involves greater transparency of the affairs of a company, and hence disclosure of the state of investments and disinvestments.³⁶ The law firm Maurice Blackburn is behind one prominent funder.
 - e. The market emerged to service the market for insolvency claims. Since 1995 under statutory powers of sale,³⁷ insolvency practitioners may contract for the funding of lawsuits, if these are characterised as company property.³⁸
 - f. Funders have expanded finance and manage class actions,³⁹ of which around 50% are shareholder cases, followed by financial services, competition and other cases.⁴⁰ Overseas funders are showing an interest in competing in the

³² This preliminary note draws heavily on three sources: the chapter by Professor Camille Cameron of Melbourne Law School, University of Melbourne on funding and costs in Australia in C Hodges, S Vogenauer and M Tulibacka, *The Funding and Costs of Civil Litigation. A Comparative Perspective* (Hart Publishing, in press); a series of papers published by Michael Legg of the University of New South Wales, noted below; a series of papers by John Walker and Wayne Attrill of IMF (Australia) Ltd, and conversations with Bernard Murphy and Peter Koutsoukis of Claims Funding International plc, to all of whom thanks are due.

³³ See Christopher Webb, 'A man named sue', *The Sunday Age*, 17 September 2006 p17 and Patrick Coope, 'Litigation Funding' (Paper Presented at The Australian Institute of Judicial Administration Conference - Affordable Justice, Adelaide, 15-17 September 2006) at 5 ("Our sole focus is to generate the best possible rate of return on our capital.").

³⁴ The Corporate Governance Manual of IMF states that 'it is almost impossible that there will be a conflict of interest between officers and employees on IMF on the one hand and any particular client of IMF on the other': Schedule to Addendum 1, para 8.1.

³⁵ See Simon Dluzniak, 'Litigation Funding and Insurance' (March 2009), p. 2, at <http://www.imf.com.au/pdf/Paper%20-%20Dluzniak.pdf>

³⁶ For information on IMF see www.imf.com.au. Some requirements are the Principles of Good Corporate Governance and Best Practice Recommendations (2003) of the ASK Corporate Governance Council.

³⁷ See eg 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) and the powers of disposal accorded to a liquidator by *Corporations Act 2001* (Cth) s 477(2)(c).

³⁸ *Movitor Pty Ltd (in liq) v Sims* (1996) 64 FCR 380 and *Re Tosich Construction Pty Ltd* (1997) 73 FCR 219.

³⁹ IMF funded the claim by shareholders against Aristocrat Leisure Ltd, which resulted in a confidential settlement but which was reported to be in excess of A\$140 million and the largest class action settlement in Australia at that time. J Walker, S Khouri and W Attrill, *Funding Criteria for Class Actions*, (IMG (Australia) Ltd, [2010]).

⁴⁰ Michael Legg, Shareholder Class Actions in Australia - The Perfect Storm? (2008) 31 (3) *UNSW Law Journal* 699 at 704 - 705.

market. Most of the funded cases are securities class actions with large numbers of class members. Some of these class members are sophisticated institutional investors and some are not.

3. **Size of market.** There are no general statistics. IMF has grown in capitalization from AUD 10 million in 1996 to AUD 200 million in 2010. In 2006, IMF (Australia) Ltd had a claim value of \$144 million in insolvency investments, \$274 million in commercial investments, and \$526 million in group actions. In 2008 the figures were \$132 million in insolvency investments, \$280 million in commercial investments and \$928 million in group actions.⁴¹ In the financial year ended 30 June 2009, IMF (Australia) Ltd received net income from litigation funding in the sum of \$35,246,957, and total net income of \$38,748,833. This represented a 21% increase in profitability from the previous year.⁴² At 31 December 2009, IMF had about AUD 55 million in cash and AUD 36 million invested and no debt. It plans to grow investments to AUD 2 billion by 30 June 2011.
4. During 2009, IMF has had over 30,000 clients. The funding agreement provides for an internal complaint handling system, leading to involvement of the Financial Services Ombudsman (a mediation service). One complaint was made in 2009, which the Ombudsman determined to be unfounded.
5. **National environment.** Australia has a costs shifting rule and a prohibition against lawyers charging contingency fees.
6. Federal Government policy is moving towards both *expansion* of the available pathways of access to justice and reviewing the options so as to provide the most *cost-effective* and appropriate pathways for particular case types. The *Commonwealth Access to Justice Report 2009* approaches ‘access to justice’ to mean access not only to courts and legal advice but also to information and a range of appropriate dispute resolution options.⁴³ It prefigures a review of public expenditure and evaluation on *all* available pathways, to evaluate them all.
7. In a typical litigation funding arrangement, the funder (usually a commercial entity) will enter into an agreement with one or more potential litigants.
 - g. The funder pays the costs of the litigation (such as the lawyer's fees, disbursements, project management and claim investigation costs) and
 - h. usually accepts the risk of paying the other party's costs in the event that the claim fails through providing the plaintiff with an indemnity.

⁴¹ W. Attrill, *Litigation Funding: Access to Justice in a Time of Economic Crisis*, presented at Globalaw Asia Pacific Regional Meeting, Auckland (20 February 2009) at <http://www.imf.com.au/pdf/Globalaw%20Conference%20-%20Feb%202009.pdf> .

⁴² See IMF (Australia) Ltd, 2009 Annual Report (2009), p. 4, at <http://www.imf.com.au/announcements/Appendix%204E%20and%202009%20Full%20Year%20Annual%20Report%20-%202009.pdf>

⁴³ Australian Government, Attorney-General's Department, *A Strategic Framework for Access to Justice in the Federal Civil Justice System*, September 2009, ('Commonwealth Access to Justice Report 2009').

- i. In return, if the claim is successful, the funder will receive a certain percentage of any funds recovered by the litigants either by way of settlement or judgment, and the litigants will assign the funder the benefit of any costs order they receive. The share of the proceeds is agreed with the litigants, and is typically between one third and two thirds of the proceeds (usually after reimbursement of costs).⁴⁴
8. In order to be able to invest in a case, a funder must have sufficient information to enable a robust risk assessment to be made.
- j. IMF's risk management process comprises the following steps:⁴⁵
 - i. IMF will investigate the facts, at its cost.
 - ii. IMF obtains an external legal opinion.
 - iii. Investment decisions are made by the internal Investment Committee, requiring a unanimous vote.
 - iv. Assessment is made of
 1. the likelihood of the claim being successful;
 2. the time it will take to establish the claim;
 3. the costs involved in pursuing the claim;
 4. the likely cost of failure; and
 5. other risks inherent in the litigation such as the inability of the defendant to pay all or part of the judgment.
 - v. Case selection is made on the basis of 'virtual certainty of success – expressed as a percentage, no case should be taken unless it is thought that it has at least an 85% chance of success or there are special reasons that the committee thinks justify a deviation from this approach'.⁴⁶
 - vi. In assessing the contingent liability represented by all adverse cost cover, IMF works on the basis that its maximum contingent liability under all adverse cost orders at any given time is represented by 66% of the cash payments made on behalf of clients in relation to those funded cases and that the liquidity buffer required to be kept by the company is 20% of that figure.⁴⁷
 - k. IMF invests in claims greater than A\$ 2 million for single commercial and insolvency claims, and will not invest more than 10% of its capital in any single case without Board approval. IMF will generally only fund multi-party litigation with a claim value in excess of A\$ 10-20 million.
 - l. Certain types of case satisfy funders' criteria, and some do not. Some types are also more commercially attractive than others. The attractive types are: breaches of market protection legislation especially continuous disclosure

⁴⁴ Carman Yung, 'Litigation funding: officious intermeddling or access to justice?' (2005) 15 *Journal of Judicial Administration* 61 at 62 and Vicki Waye, 'Conflicts of Interests Between Claimholders, Lawyers and Litigation Entrepreneurs' (2007) 19 (1) *Bond Law Review* 225 at 297. See *Jeffery & Katauskas Pty Limited v SST Consulting Pty Ltd* (2009) 239 CLR 75 for an example of a litigation funding arrangement that did not include an indemnity for adverse costs.

⁴⁵ Corporate Governance Manual (18 January 2010), para 2.1.

⁴⁶ Corporate Governance Manual (18 January 2010), para 4.18.6.

⁴⁷ Corporate Governance Manual (18 January 2010), para 4.18.10.

obligations to shareholders, product liability, and competition law especially cartel activity.⁴⁸

- m. Cases are rejected on certain criteria, including if⁴⁹
 - i. Liability evidence is irremediably too weak, too dependent on oral evidence, or requires a factually-rich and complex forensic inquiry.
 - ii. The claim is made up of too many small claims.
 - iii. The likely cost is too large.
 - iv. The defendant is unlikely to be able to meet any judgment.
 - n. Issues over confidentiality and privilege have arisen in Australia. Obstacles may arise in circumstances where the litigant is unwilling to provide such access, or the funder faces opposition to gaining access to documents discovered by the defendant in the funded litigation.⁵⁰
 - o. The litigation funder is able to spread the risk associated with a particular proceeding by adopting a portfolio approach to its inventory of cases.⁵¹
 - p. As an economic rationalist, IMF seeks to pick cases for which the chances of success exceed 60% of the value of the claim.
 - q. If the funder is going to fund a claim involving novel theories of liability and therefore take a greater risk it can offset the risk by also funding a low risk case where liability is clear. Clearly some funders have backed some cases in order to try to provoke decisions that will be favourable for the development of their business (and vice versa).
 - r. Funders take into account the practice of defendants applying for costs orders against plaintiffs.
 - s. However, the High Court has precluded a defendant from seeking a costs order against the funder under the NSW rules of court where the funder has not indemnified the plaintiff against the defendant's costs.⁵²
9. Challenges to LF based on maintenance etc resolved by the High Court of Australia in 2006 in favour of the role of funding. Arguments in favour:
- t. 'the social utility of funded proceedings'⁵³

⁴⁸ J Walker, S Khouri and W Atrill, *Funding Criteria for Class Actions*, (IMG (Australia) Ltd, [2010]).

⁴⁹ J Walker, S Khouri and W Atrill, *Funding Criteria for Class Actions*, (IMG (Australia) Ltd, [2010]).

⁵⁰ See Wayne Attrill, "Ethical Issues in Litigation Funding" (presented at the Globalaw Conference on 16 February 2009), at <http://www.imf.com.au/pdf/Ethical%20Issues%20Paper%20IMF09%20-%20Globalaw%20Conference.pdf>, p. 8.

⁵¹ A portfolio approach means that it is not enough to look at the expected risk and return of one particular investment. Investors can reduce their exposure to individual asset risk by holding a diversified portfolio of assets. Colloquially this is described as not putting all of your eggs in one basket. See Edna Carew, *The Language of Money* (3d ed 1996) 257.

⁵² *Jeffery and Katauskas Pty Limited v Rickard Constructions Pty Limited* (2009) 239 CLR 75.

⁵³ *Fostif v Campbells Cash and Carry* [2005] 63 NSWLR 203. Upheld *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386.

- u. its potential to foster the aims of Australian class action legislation⁵⁴
- v. 'inject a welcome element of commercial objectivity into the way in which [litigation] budgets are framed'⁵⁵ and
- w. increase the efficiency with which litigation is conducted.⁵⁶
- x. The High Court considered that existing doctrines of abuse of process and the courts' ability to protect their processes would be sufficient to deal with a funder conducting themselves in a manner 'inimical to the due administration of justice'.⁵⁷
- y. 'In jurisdictions which had abolished maintenance and champerty as crimes and torts, New South Wales, Victoria, South Australia and the Australian Capital Territory, there were no public policy questions beyond those that would be relevant when considering the enforceability of the agreement for maintenance of the proceedings as between the parties to the agreement.'⁵⁸ In other words, once the legislature abolished the crimes and the torts of maintenance, these concepts cannot be used to found a challenge to proceedings which are being maintained. Their only relevance is in a dispute between plaintiff and funder about the enforceability of the agreement.'⁵⁹

Support for commercial litigation funding has also come from the Law Council of Australia and the Law Institute of Victoria.⁶⁰

10. Strong criticism of the role of litigation funders and litigation funding.⁶¹

- z. The doctrinal concern that the judicial system should not be the site of speculative business ventures.
- aa. The primary aim was to prevent abuses of court process (vexatious or oppressive litigation, elevated damages, suppressed evidence, suborned witnesses) for personal gain.
- bb. Concern has been voiced that LF may turn into protection rackets, where cases are filed and disappear if the defendant pays the funder or law firm.

⁵⁴ *Kirby v Centro* [2008] FCA 1505.

⁵⁵ *QPSX Limited v Ericsson Australia Pty Ltd* [2005] FCA 933, at [54].

⁵⁶ *QPSX Limited v Ericsson Australia Pty Ltd* [2005] FCA 933, at [54].

⁵⁷ *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386 at [93]. See also *Jeffery & Katauskas Pty Limited v SST Consulting Pty Ltd* (2009) 239 CLR 75 at [26], [29]-[30].

⁵⁸ *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386 at [84]-[86].

⁵⁹ M Legg, L Travers, E Park and N Turner, 'Litigation Funding in Australia' paper at the Law Society of New South Wales Young Lawyers' 2010 Annual Civil Litigation One Day Seminar, 13 March 2010.

⁶⁰ See Law Council of Australia, 'Submission to Standing Committee of Attorneys-General', 14 September 2006; John North, 'Litigation Funding: Much to be Achieved with the Right Approach' (2005) 43 Law Society Journal 66, 69.

⁶¹ see Keane, 'Access to Justice and Other Shibboleths'.

11. Funders undertake careful and sometimes long due diligence processes before accepting cases. They look at the value of a case by its future discounted cashflow settlement value. The existence of the 'loser pays' rule means that careful assessment by a lawyer is essential of the merits of a case, and the prospects of recovery (availability of assets, and aggregation).
12. **Control.** The LF provides the instructions to the lawyer (and manages its exposure on a daily basis) but the client/lawyer can override them. Where a class has different views, IMF has poled the class to ascertain what they think (this can be done efficiently and speedily by email). IMF's experience is that most people do not have a view and are content for IMF to suggest decisions. To provide some oversight, IMF has invited institutional clients to form a committee of overseers on a case. At other times, the funding agreement specifies that decisions on settlement may be taken by Senior Counsel.
13. IMF may cease funding at its discretion and will do so if it considers that a claim is no longer meritorious. Rights to terminate are set out in the funding agreement.

 '11.6 In recognition of the fact that IMF has an interest in the Resolution Sum, if the Claimant:
 11.6.1. wants to settle the Claims or the Proceedings for less than IMF considers appropriate;
 or
 11.6.2. does not want to settle the Claims or the Proceedings when IMF considers it appropriate for the Claimant to do so;
then IMF and the Claimant must seek to resolve their difference of opinion by referring it to counsel for advice on whether, in counsel's opinion, settlement of the Claims or the Proceedings on the terms and in the circumstances identified by either IMF or the Claimant or both, is reasonable in all of the circumstances.

16. IMF is entitled, at its sole discretion, to terminate its obligations under this IMF Agreement, other than accrued obligations, by giving 7 days written notice to the Claimant ...'
14. IMF's pricing is
 - cc. Reimbursement of costs expended.
 - dd. A percentage of the Resolution Sum, which increases over time, ie the percentage increases the longer a claim takes to resolve. It is usually between 20% and 35%, plus a return of the outlay on own-side's costs.
 - ee. A Project Management Fee, calculated as a percentage of the costs of the litigation, as compensation for the higher costs involved in managing more complex and hence more expensive litigation.
15. The existence of an LF contract is disclosed to a defendant. Funders argue that there should also be disclosure by defendant to plaintiff of the existence of insurance. Walker argues that such disclosure would prevent unnecessary litigation.
16. **Regulation.** Uncertainty over what sort of regulation. The regulation of funders that has occurred thus far has been in the form of *ad hoc* judicial decisions and funder self-regulation.

- ff. The Australian Standing Committee of Attorneys General has inquired into possible regulation of LF.⁶²
- gg. The Full Court of the Federal Court ruled (2-1) in 2009 in the *Brookfield Multiplex* decision⁶³ that the arrangement between the commercial litigation funder, the law firm representing the class, and the members of the class was a managed investment scheme as defined in the *Corporations Act*.⁶⁴ One result of this decision is that the funding arrangement should have been registered under the relevant provisions of the *Corporations Act*. Another result is that other class actions underway at the time were also affected. [Only IMF was registered and held an Australian Financial Investment Services (ASIC) licence issued by the Australian Securities and Investments Commission (ASIC).]
- hh. The Australian Securities and Investments Commission intervened to grant an exemption (limited in time to 30 June 2010) to ongoing class actions affected by the decision.
- ii. In May 2010 the government noted that the decision had effectively halted all existing class actions and announced that regulations should be made carving out class actions and proof of debt arrangements from the definition of a managed investment scheme.⁶⁵ The Minister did not consider that the previous arrangements expose consumers to such high levels of risk to justify imposing licensing and other onerous requirements on class action funders. The rationale was to ‘reduce the administrative burden and red-tape’ and on the basis that ‘class actions have become an important part of the Australian justice system.’ Between 1992 and 2009 over 240 class actions were brought in the Federal Court. As at 4 November 2009, at least 21 funded class actions were in train, involving 35,000 class action members, and claims totalling an estimated \$2.6 billion.
- jj. However, the government considered that the area of potential conflicts of interest arising in assessing awards or settlements need to be properly addressed in order to enhance consumer protection.

17. Licenses required:

- kk. In Western Australia IMF is licensed as an investigator under the Securities and Related Activities (Control) Act.
- ll. When a funding agreement deals with debt, a debt collection licence is required under each state regime.

⁶² http://www.scag.gov.au/lawlink/SCAG/ll_scag.nsf/pages/scag_meetingoutcomes.

⁶³ *Brookfield Multiplex Limited v. International Litigation Funding Partners Pte Ltd (No 2)* [2009] FCAFC. This is a representative proceeding (i.e., a class action) by shareholders against Brookfield Multiplex for damages for losses allegedly caused by the company's belated disclosure of cost problems related to the construction of the Wembley Stadium.

⁶⁴ *Corporations Act 2001* (Cth). At first instance, Finkelstein J had ruled that the funded class action was not a managed investment scheme.

⁶⁵ Address by the Hon Chris Bowen MP, Minister for Financial Services, Superannuation & Corporate Law & Minister for Human Services, 4 May 2010.

mm. Only IMF held an Australian Financial Investment Services (ASIC) licence issued by the Australian Securities and Investments Commission (ASIC).

In addition, the court controls its process, certain statutory requirements apply to class actions,⁶⁶ and

18. The existence of LF has provoked some controversial decisions. After a decision that a shareholder, who challenged the validity of his investment purchase under consumer protection legislation regulating misleading disclosure, ranked in insolvency in priority to other shareholders⁶⁷ the government announced that it is to be overturned by subsequent legislation.

19. **Class actions.** Recognition that private litigation funding is the major funding source for bringing class actions has led to significant change in the procedural regime for class actions. For its first two years, IMF preferred to fund (informal) group actions rather than statutory class actions.⁶⁸

nn. The class action model under the legislation for Federal⁶⁹ and State class actions specifies an opt-out rather than an opt-in regime at the stage of declaration of a class.

oo. However, an opt-out model is simply unworkable for litigation funders. Funders need to be able to carry out a risk assessment on whether to make a potential investment, and this requires certainty over the number of members of a class from whom they can recover their costs and fees. Absent legislative change that would enable a funder to recover from all members of a class (and such a rule would be highly questionable on constitutional grounds), the right to recovery has to be contractual. Thus, funders need to have contracted with all, or at least a sufficient number, of class members before committing their money. If a significant number of class members are not contracted to the funder, a ‘free rider’ problem arises.

pp. Use of a limited class was permitted by the Full Federal Court of Australia in 2007.⁷⁰ ‘This comprised a claim by 40 corporations who alleged that the Multiplex parties had failed to disclose delays and increased costs in the Wembley stadium construction contract. The claimants’ group had signed a litigation funding agreement with International Litigation Funding Partners, Inc. (ILF), under which ILF would assume any liability of the funded parties for fees, costs or disbursements, in return, if the case was successful, for ILF obtaining reimbursement of its expenditure on costs and disbursements and receiving 30-40% of the recovery. The funding agreement terminated if a funded party settled its claim or opted out of the proceedings, but the funded party would remain liable to apply any payment received as provided under the agreement.’⁷¹

⁶⁶ Eg Federal Court of Australia Act 1976 (Cth), s 33C in class actions.

⁶⁷ *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160.

⁶⁸ J Walker, S Khouri and W Atrill, *Funding Criteria for Class Actions*, (IMG (Australia) Ltd, [2010]).

⁶⁹ Pt IVA of the *Federal Court of Australia Act 1976* (Cth), s 33J.

⁷⁰ *Multiplex Funds Management Ltd v P Dawson Nominees Pty Ltd* (2007) 164 FCR 275.

⁷¹ M Legg, L Travers, E Park and N Turner, ‘Litigation Funding in Australia’ paper at the Law Society of New South Wales Young Lawyers’ 2010 Annual Civil Litigation One Day Seminar, 13 March 2010.

- qq. The court based its decision on interpretation of the statutory provision that a representative party could represent 'some of all' of the class. Accordingly, the action need not be brought on the basis that all the possible members of the class were represented. The court distinguished between the Aristocrat class action, which impermissibly defined the group by reference to persons who retained MBC both before and after the commencement of the relevant proceeding, and the Multiplex class, which limited the group at the time the proceedings were commenced.
 - rr. This raises issues of exclusivity. Australian funding agreements typically provide that clients will not be liable for adverse costs, and that the risk is covered by the funder. Prof Cashman argues that if a representative plaintiff turns out to have a bad case and has to drop out, the lawyers assume liability for costs and are prevented from proceeding with other good cases in the class, so it would be preferable for the lawyers to have no liability for costs and not get into funding cases.
20. There is debate over whether LFs should be able to provide a 'complete service' to a client. John Walker of IMF argues that many clients wish to hand all decisions over to the LF, who is in a position to provide an expert service in handling a case, and capable of taking all decisions. Some argue that this may be a step too far from client autonomy and control over their own affairs.

