

**LITIGATION FUNDING
&
CAUSALLY CONNECTED LOSS**

**FORENSIC ACCOUNTING & BUSINESS VALUATIONS CONFERENCE
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1. Introduction

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

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

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

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

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

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The High Court in *Fostif (Campbells Cash and Carry v Fostif)* [2006] HCA 41) found:

- (a) there to be no public policy against litigation funding; and
- (b) the funder's control of the proceeding not to be an abuse of process.

The three main effects of *Fostif* has been:

- (a) cases funded by third party funders are no longer delayed by interlocutory disputes over whether the funding is an abuse of process;
- (b) funders involvement in cases they fund has increased; and
- (c) more capital has been directed to the market and more funders have appeared.

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

2. Types of Causes of Action Funded

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

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

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

Insurable Risk Cases also make up the vast majority of cases obtaining After The Event

insurance in the United Kingdom litigation funding market discussed below.

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

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

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

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

3. The Cost/Benefit of Funding

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

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

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

- reimbursement of all money it has expended; and

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- an agreed percentage of the “resolution sum” – usually between 20% and 40%.

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

The litigation funder does not provide legal advice to the claimant. It is not a “client” of the solicitor and it does not interfere in the solicitor/client relationship.

4. Investments

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

According to the IMF Investment Portfolio report released to the ASX for 31 December 2008, IMF had investments in 28 cases (where the budgeted IMF fee is greater than \$500,000 in each case).

Of these 28 cases:

- (a) 3 are Insolvency related;
- (b) 6 are Commercial Litigation claims; and
- (c) 19 are Group Actions.

5. Markets

In terms of maximum claim value:

- (a) Insolvency cases comprise 5% of the total maximum claim value;
- (b) Commercial claims comprise 6%, and
- (c) Group Actions comprise 89% of the total maximum claim value.

6. Class Actions Funded by IMF

IMF commenced funding class actions in 2001. In the last eight years, 30 multi party actions have been filed and funded by IMF, 15 being class actions and 15 being group proceedings where all claimants were named as plaintiffs.

About twenty percent of these claims relate to disparate subject matter, including price fixing cartels, misfeasance in public office, airline death claims in the USA, unconstitutional tobacco taxes and misleading conduct on the waterfront.

The second largest grouping of claims include losses caused by contraventions of financial services market protection legislation to investors in managed investment schemes and debt markets.

The largest market for funded class actions has been shareholder claims, which account for about half of the claim value of all IMF funded claims.

7. The Population at Risk of Shareholder Claims

Shareholder claims are likely to be limited, in broad terms, to the following:

- (a) listed companies;
- (b) companies with sufficient market capitalisation, trading volumes and analyst coverage;
- (c) where there is a material, egregious non disclosure or misrepresentation; and
- (d) where there is a material drop in the price of the shares on large volumes directly after the corrective announcement.

Small cap stocks, thinly traded, without analyst support are unlikely to be the subject of commercially viable causes of action by shareholders as the quantum of the claims are unlikely to justify the cost of the proceedings. This is due particularly to the fact that the market in these stocks are unlikely to be efficient, requiring proof of causally connected loss from each and every victim.

8. A Quick Material Drop on Large Volumes

A material drop in the price of the shares on large volumes directly after the corrective announcement, is important for a number of reasons:

- (a) the drop, prima facie, is likely to be causally related to the disclosure, being strong evidence that the market may have been trading at an inflated price as

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- a result of non disclosure of material information;
 - (b) the quantum of the action is likely to be sufficiently material to make the project commercially viable;
and
 - (c) shareholders, particularly institutional investors, are likely to be sufficiently concerned about the behaviour of the company, to want to be involved in the litigation as a class member.

The materiality of the non disclosure or misrepresentation and its causal connection to any loss is reflected in the market's reaction to the corrective statement.

Two shareholder claims that have recently been before the courts illustrate the importance of the market's reaction.

The first is the Telstra shareholders' claim which alleged that information selectively provided to the Federal Government was material and yet when the market became aware of the information, there was not perceivable reaction. This meant it would always be difficult in the shareholder action against Telstra to prove:

- (a) materiality of the non disclosure;
- (b) a causal connection between the non disclosure and any loss; and
- (c) material loss.

Contrast this circumstance to Aristocrat which had its market capitalisation drop on large volumes by 70 percent directly after a string of profit downgrades.

IMF was approached by many angry victims, but after 5 months of due diligence there was no evidence that Aristocrat had delayed in making the announcements. Unfortunately for Aristocrat, in proceedings against the relevant Aristocrat CEO (Des Randall), Aristocrat cross claimed against Randall alleging that he had caused the company not to comply with its continuous disclosure obligations. Proof of non disclosure was provided on a platter by the Company. If only it was always that simple.

The quantum of funded shareholder claims is primarily a factor of three elements:

- (a) the number of shares purchased in the period of non disclosure;
- (b) the inflation in the stock at the purchase dates, or the difference between purchase price and sale price, depending upon the proper test for quantifying loss;
- (c) the demand by victims to be involved in the project.

This last factor, in practical terms, involves the liability and quantum evidence being reviewed by IMF and by the in house counsel in each institution **and** individual decisions being made as to fund or whether to join the project. Only when there is sufficient market support, is there a viable cause of action.

9. The Interaction Between ASIC and IMF

The broad distinction between ASIC and IMF is our motivations. ASIC, in broad terms, relevantly focuses on regulating markets and penalty provisions whereas IMF focuses on obtaining compensation for victims of market abuse.

A good example of how we sometimes interact is in an application by IMF's clients to seek to have a Deed of Company Arrangement between Lehman Australia and its creditors set aside. ASIC intervened in those proceedings based on policy considerations supporting IMF's assertions that Lehman Australia did not have the statutory power to enter into a DOCA which purports to require its creditors to release claims they have against other companies in the Lehman Group.

Another example is where IMF commenced proceedings for its clients who lost money in the Westpoint debacle. ASIC subsequently commenced proceedings to obtain compensation for victims of Westpoint who were not IMF clients.

ASIC has also facilitated resolution of IMF claims in the past against licensees who obtain and return their licences at the behest of ASIC.

In the future, IMF may seek to rely on findings of the Court in penalty proceedings conducted by ASIC in order to make compensation proceedings commercially viable.

Time will tell.

Dated: 13 August 2009

John Walker

Executive Director

IMF (Australia) Ltd