

## **LITIGATION FUNDING FOR CONSUMERS OF CIVIL JUSTICE SYSTEM SERVICES**

### **1. Litigation Funding in Perspective**

The recent increase in litigation funding is caused by strong demand from people who cannot afford to access our civil justice system.

Funding, however, is not the solution to all consumer access issues. It has evolved due to the cause of the problem; namely the costs and delays in our adversarial process. Real and lasting gains will only be made by diminishing these barriers which unquestionably should be at the centre of the litigation funding policy debate.

In 1997, the High Court of Australia's Chief Justice Brennan declared that the Australian "*system of administering justice is in crisis due to costs and delays.*"

Almost 10 years later, Chief Justice Murray Gleeson, in an Access to Justice Conference in Melbourne in August, acknowledged that it is questionable whether we have a civil justice "system" where judges, the parties and their lawyers do not work towards common objectives; where, adversaries looking after their self interests, principally determine the cost and time proceedings take, with the judiciary having limited capacity to influence these factors.

This acknowledgement requires costs and delay in our adversarial process to be front and centre in any policy considerations concerning litigation funding.

### **2. Litigation Management by Funders and Insurers**

Currently funders of plaintiffs in Australia invest about \$20 million per year whereas insurers would expend at least 50 times that figure in funding the defence of insured civil claims.

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

The insurance analogy is also relevant to the law that is available to address conflicts of interest between funders and funded parties. The law assumes that a lawyer-client relationship exists between the solicitor, appointed by the insurer, and the insured, but not necessarily to the exclusion of a similar relationship with

the insurer. Both insurers and the solicitors they appoint owe a duty to the insured to conduct the proceedings with due regard to the latter's interests and an action for damages will lie for breach of that duty. Additionally, insurers have the right to decide upon the proper tactics to pursue in the conduct of the litigation, provided that they do so in what they *bona fide* consider to be in the interests of themselves and the insured. When the insurer takes over the conduct of the insured's defence, each party comes under an obligation, as a matter of contractual implication, to act in good faith with due regard to the interests of the other.

These common law rules that have been formulated to deal with insurance contracts are readily adaptable to the regulation of litigation funders presently under consideration. Indeed, there seems no reason in principle or policy for a funder's involvement in litigation to be regulated differently to insurers. At the extreme, if funders are regulated in an environment where insurers remain unregulated, there will be a tendency to worsen the inequality of arms between claimants and insurers presently so clearly in existence.

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

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

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

### **3. Adversarial Process Litigation Risks**

It is unfortunate, to say the least, that the vast majority of Australians can not afford to run the gauntlet of the litigation risks inherent in our civil justice system unless they are financed by their lawyers on a no win no fee basis or obtain litigation funding or are insured.

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

- (a) not being able to obtain a budget from their solicitor, let alone a set fee;
- (b) not being able to predict how long the litigation process will take with any degree of certainty;
- (c) a pricing policy by the lawyers requiring payment for hourly rates;

- (d) confronting well resourced defendants with the capacity to obtain the best legal and expert advice; and
- (e) confronting legal advice they may find difficult to understand or which does not properly identify the liability, quantum, enforcement, and other commercial risks, including how much the potential adverse costs order may be in dollar terms.

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

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

#### **4. Types of Causes of Action Funded**

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 broadly limited to medium to high value Commercial Litigation principally in the Supreme and Federal Courts in each State of Australia.

Personal injury, workers compensation 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.

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

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

As a result of this experience, when it listed in 2001, IMF included a minimum claim size in IMF's Investment Protocol of \$2 million in acknowledgement of the fact that the cost of Commercial Litigation together with the associated risks, currently make funding small claims commercially unviable.

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

Where this can be achieved, claims each of less than \$10,000 in value can be processed economically, returning funded parties about \$7,000. This outcome

was achieved for about 8000 IMF funded parties in a Group Action against British and American Tobacco and Phillip Morris in 2003.

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

## **5. Is the Price of Litigation Funding Fair?**

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

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

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

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

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

Finally, discussion concerning proportionality of costs in the Civil Justice System will become more prevalent in the near future, with funding costs a part of that discussion. If you asked 10 consumers whether they would prefer to pay a defined percentage of the outcome rather than hourly rates that could eat up the whole claim value, I have a reasonable expectation of what the 10 responses would be.

In fact, IMF has not received one complaint from its 15,000 or so clients over the last 5 years; I daresay a strike rate unmatched by legal service providers in the civil justice system.

## **6. Litigation Funding Markets**

IMF funds claims that can be classified into one of three categories: Insolvency, Commercial Litigation and Group Actions and lodges a quarterly report with the ASX for its major cases identifying the maximum claim value and classification for each.

Of these 35 cases:

- (a) 12 are Insolvency related;
- (b) 13 are Commercial Litigation claims; and
- (c) 10 are Group Actions.

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

In terms of maximum claim value:

- (a) Insolvency cases comprise 20% of the total maximum claim value;
- (b) Commercial claims comprise 30%, and
- (c) Group Actions comprise 50% of the total maximum claim value.

Approximately 50 percent of these IMF funded claims have their defence managed and funded by insurers pursuant to professional indemnity or directors and officers policies.

## **7. Data Collation on Litigation Funding Market**

IMF invests about \$12 million per year in funding of cases, with all funders investing about \$20 million in total. Whilst there is currently no specific public data available, insurers' defence management expenditure in our civil justice system would certainly exceed \$1 billion per year. Given the utilisation by funders and insurers of our subsidised civil justice system, I invite the Standing Committee to think about collecting relevant data to ensure the funder and insurer interface with our civil justice system is understood and appropriately regulated.

This data would include:

- (a) the number, type and value of claims funded by each funder and the number type and value of defended claims funded by each insurer;
- (b) the cost of the litigation to the funders, insurers and the Courts;
- (c) the levels at which the parties were prepared to settle the case; and
- (d) the value of settlements or judgments and the time each proceedings took to resolve.

This data could provide some surprising statistics. For example, it is acknowledged by members of the insurance industry that about 75 cents in every dollar paid out by insurers on directors and officers policies goes in defending the claims, with only 25 cents going to the claimants. This type of statistical data was powerfully used in the recent tort reform debate and must be relevant in any litigation funding debate.

## **8. Civil Justice Reform**

If any government was prepared to identify how many Australians could afford the cost and assume the risk of medium to large scale civil litigation, I dare say the percentage would be found to be negligible.

In order for our Courts to provide justice, they must be accessible, or justice is denied. Wayne Martin, the new Chief Justice of the Supreme Court of Western Australia in August 2006 referred to his State's justice system as the:

*“Rolls Royce of justice systems in the sense that it is the best that money, a lot of money, can buy. But there isn't much point in owning a Rolls Royce if you can't afford the fuel to drive it where you want to go. You can polish it, admire it and take pride of ownership from it but it doesn't perform its basic function sitting in the garage.”*

Then he went on to say:

*“It might be time to consider trading our Rolls Royce for a lighter, more contemporary and more fuel efficient vehicle which will get us where we need to go just as effectively and perhaps more quickly.”*

Ever growing consumerism in our society will demand a more “fuel efficient” system accessible to most Australians to replace the current “Rolls Royce” system accessible by only Australians capable of affording the Rolls.

I take the liberty today of listing some measures which could have a profound impact upon access, cost and delay.

### **(a) Just, Quick and Cheap Resolutions of the Real Issues**

The New South Wales legislature has identified an objective for its civil justice system, which I commend to all other States and Territories in the unification process.

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

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

With respect to the legal profession, almost all lawyers currently consider their fiduciary and contractual duties to their clients to take precedence over their duties to the Court in its quest for just, quick and cheap resolution of claims.

I consider section 56(4) ought to be amended to require **lawyers**, consistently with their clients, to assist the Court in its overriding purpose.

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

With these concerns in mind, it seems appropriate to:

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

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

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

**(b) Compulsory Litigation Budgets & Time Lines**

Compulsory litigation budgets and time lines circulated by lawyers at or near the commencement of proceedings could be utilised:

- (a) by **parties** to determine the cost / benefit: risk / reward decision of whether to proceed;
- (b) by **Courts**:

- (i) to monitor excessive costings or time lines;
  - (ii) to case manage the Court process to ensure reasonable budgetary and timing expectations are achieved;
  - (iii) to enable claims by lawyers to payment of costs which exceed budget to be reviewed by the Court by reference to the budget rather than time costings; and
  - (iv) to quantify adverse cost orders, rather than the assessment or taxation processes currently utilised, and
- (c) by the **lawyers** to seek to deliver resolution of claims in accordance with their clients' expectations and their duty to the Court.

The first step in compulsory budgets and time lines has been taken by the New South Wales cabinet with the relevant Bill not yet before parliament. Perhaps Laurie would be able to confirm the current status of this Bill.

The secondary steps I referred to earlier, would:

- (i) create greater certainty for consumers in civil justice system services, thereby making the system more accessible;
- (ii) provide the Court with the benefit of the duty owed to it by all parties, lawyers, funders and insurers consistent with the Court's overriding purpose; and
- (iii) address Chief Justice Murray Gleeson's acknowledged state of affairs that we do not have a civil justice system where judges, the parties and their lawyers work towards common objectives.

This reform, before all others, will increase the supply of litigation funding and diminish its price.

(c) **Demotivating Costs & Delays**

In addition to the matters previously addressed, it is imperative that incentives for the judiciary, parties, lawyers, funders and insurers to increase costs or cause delay, are minimised.

This would involve:

- (a) the judiciary acknowledging parties before the Court have legitimate consumer interests in the court achieving its overriding purpose;
- (b) plaintiffs and defendants being penalised with cost orders for only offering to settle the claim at more than or less than any subsequent judgment;
- (c) lawyers having to obtain court approval for payment of fees above their initial budgets;
- (d) funders and insurers being directly liable for adverse cost orders; and
- (e) defendants and insurers being liable to pay the claimant:
  - (i) the return they made on investing the judgment proceeds (with insurers return on investment over the last 5 years being in excess of 20% per annum compounding); and
  - (ii) half of any tax deduction obtained for their defence expenses where the claimant's expenses are not tax deductible.

## **9. Conclusion**

It seems in everyone's legitimate interests, that our civil justice system in all States and Territories be unified, simplified, quicker, cheaper and therefore accessible.

The alternative is to simply acknowledge our laws are largely unenforceable, with consequent detrimental effects on the integrity of our markets and respect for our Courts.

Litigation funding is not the answer; merely a band aid. Real advances will be made focusing on the Overriding Purpose of our civil justice system and looking to ensure all stakeholders are focused on this purpose.

**John Walker**

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