

## LITIGATION FUNDING AN INTERNATIONAL PERSPECTIVE<sup>1</sup>

### What is Litigation Funding?

1. Litigation may be funded in a number of different ways, including:
  - (a) by way of loan on a full recourse or limited recourse basis (limited to any recoveries), often with security over the cause of action and the recoveries;
  - (b) by way of gift, for example by a concerned relative;
  - (c) out of obligation, for example trade union funding of employee causes of action;
  - (d) through legal aid;
  - (e) by solicitors who are acting on “no win, no fee” basis; and
  - (f) by a commercial entity for profit (including by insurers pursuant to “After the Event” insurance).
2. Both plaintiffs and defendants can be the recipient of litigation funding, but typically funding is on the plaintiff side due to the availability of a source of funds, namely the recoveries, from which a funder can receive a return.
3. This paper concerns commercial funding for profit, which is typically provided in one of 2 ways; either:
  - (a) the funder receives an assignment of the cause of action in return for a payment upfront or at the conclusion of the litigation and sometimes calculated by reference to a percentage of the recoveries; or
  - (b) the funder receives an assignment of some or all of the recoveries (referred to as the “fruits” of the cause of action) in return for agreeing to pay the legal costs (often including any costs in favour of the other side). The funder also usually has a right to be reimbursed any costs it has paid from the recoveries.

---

<sup>1</sup> By Clive Bowman, Executive Investment Manager, IMF (Australia) Ltd

4. In the case of an assignment of the cause of action, the funder, as assignee, conducts the litigation in its own name. In the case of an assignment of the fruits of the action, the assignor conducts the litigation in its name. The latter method of funding is more typical, at least in Australia.
5. There need not be an assignment of either the cause of action or the fruits of the action. There could simply be an agreement to fund in return for payment of a percentage of the recoveries. However, typically funders have taken an assignment for 2 reasons:
  - (a) historically, funding of Insolvency Practitioners has been treated as legitimate because there is an assignment of the cause of action or the fruits, being property of the company; and
  - (b) an assignment of the fruits of the action, which operates as an immediate disposition of future property, is seen as providing the funder with an interest that ranks ahead of unsecured creditors of the funded entity, who may seek to make a claim on the recoveries if the action is successful.
6. The risk the funder assumes is that the case it is funding is lost. This will entail a loss of capital, being the costs it has paid to fund the case and the costs in favour of the other side (if there is a costs order in favour of the other side and if the funder is liable for them).
7. The primary risk the funded party assumes is that the funder does not have the capital to see the case through or to pay a costs order (leaving the funded party exposed to pay it).
8. Due diligence is critical for both sides. For the funder the following factors will be relevant:
  - (a) the strength of the case;
  - (b) the likely costs to run it;
  - (c) the likely time to conclusion of the case;
  - (d) the likely quantum;
  - (e) the capacity of the defendant to pay; and
  - (f) the integrity of the funded party, including whether they are likely to act rationally to reasonable settlement offers.

9. For the funded party, it will be important that the funder has integrity, has complied with all relevant licensing requirements, has a positive track history, and has the capacity to meet its obligations.
10. Both parties assume the risk that the case will be stalled or stopped because of issues concerning the funding, primarily to do with the ancient rules of maintenance and champerty. For both, the legality of the funding transaction will be important.

### **The Application of ancient rules of Maintenance and Champerty**

11. Litigation funding by third parties for profit constitutes assistance in the pursuit of the litigation in return for a share in the proceeds.
12. Such arrangements are potentially champertous.
13. Halsbury's Laws (4th ed) defines "Maintenance" as:

"the giving of assistance or encouragement to one of the parties to litigation by a person who has neither an interest in the litigation nor any other motive recognised by the law as justifying his interference".

14. "Champerty" is defined as:

"a particular kind of maintenance namely maintenance of an action in consideration of a promise to give the maintainer a share in the proceeds or subject matter of the action"

15. Maintenance and champerty have ancient origins. The doctrines emerged in medieval times when corruption was common place. As Lord Mustill in *Giles v Thompson* [1994] 1 AC 142 said:

"The mechanisms of justice lacked the internal strength to resist the oppression of private individuals through suits fomented and sustained by unscrupulous men of power. Champerty was particularly vicious, since the purchase of a share in litigation presented an obvious temptation to the suborning of justices and witnesses and exploitation of worthless claims which the defendant lacked the resources and influence to withstand.

....

As the centuries passed the Courts became stronger, their mechanisms more consistent and their participants more self-reliant. Abuses could be more easily detected and forestalled, and litigation more easily determined in accordance with the demands of justice, without recourse to separate proceedings against those who trafficked in litigation."

### Public Policy is the determining factor

16. Lord Mustill recognised (as many others have also done) that the origins of maintenance and champerty lay on considerations of public policy designed to protect the purity of justice and the interests of vulnerable litigants.
17. Public policy is not static. Accordingly, whether conduct amounts to a contravention of common law offences and the tort of maintenance and champerty has changed over time in accordance with changes in public policy.
18. As the Hong Kong Court of Final Appeal recognised in *Siegfried Adalbert Unruh v Hans – Joerg Seeberger* [2007] HKEC 268:

“The early policy imperatives have long gone and by the 19<sup>th</sup> century it was widely recognised that maintenance and champerty had acquired a wholly different complexion. Thus in 1883 Lord Coleridge CJ stated that the old authorities “hold a multitude of things to be maintenance which would not be held so now....” and in 1982, Lord Rostill commented that in the 20<sup>th</sup> century, “the Courts have adopted an infinitely more liberal attitude towards the supporting of litigation by a third party than had previously been the case”. [at 89]

19. Importantly, in recent times, increasing concerns about access to justice have driven an increasing acceptance of litigation funding. As an example, the Court in *Gulf Azov Shipping Co Limited v Idisi* [2004] EWCA CW 292 said:

“Public policy now recognises that it is desirable in order to facilitate access to justice, that third parties should provide assistance designed to ensure that those who are involved in litigation have the benefit of legal representation.” [54]

20. The increasing acceptance of litigation funding based on modern perceptions of the dictates of public policy is a worldwide phenomenon, although some common law jurisdictions have been more accepting than others.

### The Australian Position

21. In Australia, maintenance and champerty is no longer a crime, but is a tort in states other than New South Wales, Victoria and South Australia. The rules of maintenance and champerty remain part of the law in so far as they impact on contracts to be treated as contrary to public policy or otherwise illegal.

- 
22. The Australian High Court in *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* (“Fostif”) [2006] 229 ALR 58, confirmed by a 5:2 majority that it is not contrary to public policy under Australian Law for a funder to finance and control litigation in the expectation of profit and that litigation funded on this basis does not amount to an abuse of the Courts’ process.
23. The claim was a representative proceeding on behalf of numerous small tobacco retailers seeking a refund of licence fees paid to the defendant tobacco wholesalers.
24. The funding agreement conferred significant powers on the funder. In particular, the funder:
- (a) sought out the claimants through an extensive advertising and direct marketing campaign and organised the claimants into the proceedings;
  - (b) retained the solicitor to act for the claimants and forbade the solicitor from directly liaising with the claimants;
  - (c) gave all instructions to the solicitor in relation to the conduct of the proceedings;
  - (d) had the power to settle the claims with the defendants (provided the amount of the settlement was not less than 75% of the amount claimed);
  - (e) would receive up to 33.3% of any amounts recovered by the claimants; and
  - (f) would retain any amounts awarded to the claimants for costs.
25. The Majority of the High Court held that neither the funder’s conduct in seeking out persons who might have claims or the terms of the funding arrangement which gave the funder control of the litigation in the expectation of a significant profit were contrary to public policy or led to any abuse of process. In relation to control the New South Wales Court of Appeal (whose decision was confirmed by the High Court) said:
- “....a measure of control is essential if the funder is to manage group litigation and also protect its own legitimate interests. The funder’s control in the present case is not excessive, especially since there is a solicitor on the record and since these are representative proceedings under judicial supervision”. [137]
26. Their Honours went on to consider two fears associated with litigation funding: fears about possible adverse effects on the litigation process and fears about the fairness of the bargain struck between the funder and the client. They concluded that: “To meet these fears by adopting a rule in either form would take too broad an axe to the problems that may be seen to lie behind the fears.” [91]

27. They rejected a role for the Courts in assessing whether a funding agreement was “fair” as this assumed, wrongly, that “there is some ascertainable objective standard against which fairness is to be measured and that the Courts should exercise some (unidentified) power to relieve persons of full age and capacity from bargains otherwise untainted by infirmity” [92]. And in response to Lord Denning MR’s oft-repeated warning in *In re Trepca Mines Ltd (No 2)* that the “common law fears that the champertous maintainer might be tempted, for his own personal gain, to inflame damages, to suppress evidence, or even to suborn witnesses”, the majority replied:

“Why is that fear not sufficiently addressed by existing doctrines of abuse of process and other procedural and substantive elements of the Court’s processes? And if lawyers undertake obligations that may give rise to conflicting duties there is no reason proffered for concluding the present rules regulating lawyers’ duties to the Court and to clients are insufficient to meet the difficulties that are suggested might arise.” [93]

28. The majority recognised the practical reality of multi-party litigation and the positive role that funding can play in promoting access to justice. Underpinning their judgment was a determination to ensure that the defendants were not able to take advantage of “some general rule of public policy that a defendant may invoke to prevent determination of the claims that are made against the defendant”. [95]

### **The UK position**

29. In the United Kingdom, maintenance and champerty were abolished as crimes and torts in 1967, but still remain a part of English Law in so far as the circumstances in which contracts can be treated as contrary to public policy or otherwise illegal are concerned.

30. A modern summary of the position of the law in the UK is found in *London & Regional (St George’s Court) Ltd v Ministry of Defence* [2008] EWHC 265 at [103]:

“Many of the relevant authorities in this area of the law have been helpfully summarised by Underhill J in *Mansell v Robinson* [2007] EWHC 101 (QB). He concluded that:

- (a) the mere fact that litigation services have been provided in return for a promise in the share of the proceeds is not by itself sufficient to justify that promise being held to be unenforceable: see *R (Factortame Ltd v Secretary of State for Transport (No. 8))* [2003] QB 381;
- (b) in considering whether an agreement is unlawful on grounds of maintenance or champerty, the question is whether the agreement has a tendency to corrupt public

justice and that such a question requires the closest attention to the nature and surrounding circumstance of a particular agreement: see *Giles v Thompson*;

(c) the modern authorities demonstrated a flexible approach where courts have generally declined to hold that agreement under which a party provided assistance with litigation in return for a share of the proceeds was unenforceable: see, for example, *Papera Traders Co Ltd v Hyundai (Merchant) Marine Co Ltd (No.2)* [2002] 2 Lloyd's Rep 692; and

(d) the rules against champerty, so far as they have survived, are primarily concerned with the protection of the integrity of the litigation process in this jurisdiction: see *Papera*".

31. In the UK, the Courts have embraced litigation funding for profit on the basis that it promotes the policy objective of access to justice, but they have not gone as far as the Australian High Court has in endorsing control by the funder over the litigation.

32. In *Arkin v Borchard Lines Ltd & Ors* [2003] EWHC 2844 ("*Arkin*") the trial judge held that:

"It is indeed highly desirable that impecunious claimants who have reasonable sustainable claims should be enabled to bring them to trial by means of non-party funding. It is further highly desirable in the interests of providing access for such claimants to the courts that non-party funders, such as MPC should be encouraged to provide funding, subject always to their being unable to interfere in the due administration of justice, particularly in order to forward their own interest in their stake in the amount recovered". [71]

33. On appeal, the Court of Appeal endorsed the trial judge's sentiments concerning the desirability of litigation funding.

34. On the question of the funder's liability for costs, the Court of Appeal held that the rules concerning costs following the event and the reasons for those rules "render it unjust that a funder who purchases a stake in an action for a commercial motive should be protected from all liability for the costs of the opposing party if the funded party fails in the action" [38].

35. In an approach not yet arisen for consideration by Australian Courts, the Court of Appeal considered that the professional litigation funder should not be liable for all of the costs of the case (which had been lost by the funded plaintiff), based on concerns that this might discourage funding and so be contrary to aims of promoting access to justice.

36. The Court of Appeal limited the liability of the funder to the costs of the opposing party to the extent of the costs provided. It recognised that a likely consequence was that professional funders would be likely to cap the funds they provide so as to limit their exposure to adverse costs to a reasonable amount.

### The position in South Africa

37. In South Africa, the Supreme Court of Appeal of South Africa in *Price Waterhouse Coopers Inc & Ors v National Potato Co-operative Ltd*, in a judgment delivered on 1 June 2004, attributed the historical condemnation of champerty to concerns for the integrity of the judicial system and found that “as the civil justice system had developed its own inner strength the need for the rules for maintenance and champerty has diminished – if not entirely disappeared” [32].
38. The Court concluded that the civil justice system was strong enough to deal with any abuses that might arise if litigation is made possible by third party funding in return for a share of the recoveries. Accordingly, such arrangements were not contrary to public policy.

### The position in New Zealand

39. The High Court of New Zealand (New Zealand’s court of first instance for major claims) in *Houghton v Saunders & Ors* [2008] NZHC 1569 relied heavily on the Australian decision in *Fostif* in finding that the funding agreement in that case, which gave day to day control of the litigation to the funder of representative proceedings, did not amount to an abuse of process and as such would not warrant a stay.
40. Justice French noted that in recent times there had been a “dramatic change in attitude” to maintenance and champerty with the Courts generally adopting a more liberal and relaxed approach.
41. Justice French identified the relevant concerns as being with the fairness of the bargain struck between funder and funded party and the adverse effects on the processes of litigation (at [182]).
42. The funding agreement provided for the funder to receive 33% of any damages or settlement (rising to 38% in the case of an appeal) and a project management fee of 25% of the total costs of the project. The profit the funder stood to make, if the claim succeeded, was very substantial (possibly \$80 to \$90m).
43. The Court was referred to Australian decisions where the Court has approved funding agreements where the percentages were higher (75% in *Buiscecx Ltd v Panfida Foods Ltd (in liq)* [1998] NSWSC 516, 66.6% in *Bell Group v Westpac* (1993) 18 WAR 21 and 55% in *Bandwill Pty Ltd v Spencer Lauff* [2000] WASC 210).
44. Notwithstanding that the Australian High Court decision in *Fostif* was made in the context of a jurisdiction (New South Wales) where maintenance and champerty had been aborted as a crime

and a tort (and in New Zealand the tort of champerty remains), the Court felt that the principles in *Fostif* were of sufficiently general application so as to be relied on.

### **The position in Ontario, Canada**

45. The Ontario Superior Court of Justice in *Metzler Investment GmbH v Gildan Activewear Inc & Ors*, in a decision handed down on 6 August 2009, took a more conservative approach than that taken in Australia and New Zealand in considering whether to approve a third party litigation funding agreement in the context of a class action.
46. Under consideration was an Indemnification Agreement whereby the funder agreed to indemnify the lead plaintiff in the class action for any adverse costs order. The lawyers for the lead plaintiff were conducting the case on a contingency fee arrangement.
47. Although the Court was referred to the cases of *Fostif* and *Arkin*, the defendants argued that these cases were not particularly relevant because contingency fee agreements are not permitted in Australia (in contrast to Ontario) and are only permitted for non-contentious litigation in England. Further, they argued that in *Arkin* the plaintiff was impecunious (which was not the case here).
48. After a review of Canadian cases including those concerning fee arrangements, the Court concluded that there are 2 critical elements that constitute a champertous agreement with respect to third party funding agreements:

“First, the involvement must be spurred by some improper motive. Second, the result of that involvement must enable the third – party to possibly acquire some gain following the disposition of the litigation” [44].
49. As the funder would clearly gain from a positive outcome, the motivation of the funder was seen as critical.
50. Even though the Indemnification Agreement gave the funder no control over the litigation, the Court objected to the terms that enabled the representative of the funder to attend settlement discussions and permitted the funder to terminate its obligations on 7 days notice.
51. In respect of the termination provisions, the Court found that the termination right “could amount to officious intermeddling and could create the potential for this litigation to be influenced by extraneous interests and agendas. The ability to terminate the Agreement without cause should therefore be deleted...”[60].

52. This position is contrary to that taken in Australia, as exemplified by the case of *Spatialinfo Pty Ltd v Telstra Corporation Ltd* [2005] FCA 455 (22 April 2005). In that case, Sundberg J found that the right of IMF to terminate the funding agreement was an almost unavoidable feature of a litigation funding agreement and was not an indirect mechanism to control the litigation.
53. With the provisions referred to above deleted, the Court held that the Indemnification Agreement did not contravene public policy, but that there was still an issue as to whether the agreement was champertous which required an examination of the funder's motive.
54. The Court followed the approach of the Ontario Court of Appeal in *McIntyre Estate v Ontario (Attorney General)* (2002) 61 OR 931) 257 (C.A.), adopting what the Court said at [76] as follows:
- “When considering the propriety of the motive of a lawyer who enters into a contingency fee agreement, a Court will be concerned with the nature and the amount of the fees to be paid to the lawyer in the event of success. One of the originating policies in forming the common law of champerty was the protection of vulnerable litigants. A fee agreement that so over-compensates a lawyer such that it is unreasonable or unfair to the client is an agreement with an improper purpose – *i.e.*, taking advantage of the client”.
55. This reasoning was applied to the Indemnification Agreement.
56. Although the Court accepted that it would not be appropriate to inquire into the amount of the fee payable were only the plaintiff liable to pay it, here all class members would be liable to pay it, and this required the Court to assess the fairness and reasonableness of the compensation payable to the funder.
57. The Court concluded that as the amount of compensation related completely to the amount of money recovered (7% of the recoveries) it was impossible to conclude, at this stage of the proceedings, what that amount was and consequently whether there was “over compensation”. Thus, the Court held that it could not now declare that the agreement did not involve maintenance and champerty.
58. It appears that the Alberta Court of Queen's Bench has also approved an indemnity agreement in conjunction with a contingency fee arrangement in a class action, in June 2009. The application was *ex parte* (and so did not involve a contradictor) and the finance arrangement was sealed and so not public (*Don Hobsbawn v ATCO Gas and Pipelines Ltd*)

---

## The position in Hong Kong

59. In Hong Kong, the leading authority on maintenance and champerty is the Court of Final Appeal's decision in *Siegfried Adalbert Unruh v Hans-Joerg Seeberger* ("Unruh") of 9 February 2007.
60. The Court reinforced that common law rules making maintenance and champerty criminal offences, torts and a ground of public policy for invalidating tainted contracts, were part of Hong Kong Law prior to 1997 and remain applicable by virtue of Article 8 and the Basic Law. The recent conviction in Hong Kong of a solicitor and claim agent on the counts of maintenance and champerty makes it clear that maintenance and champerty remains a criminal offence.
61. The Court recognised 3 non static categories of cases excluded from the ambit of liability for maintenance and champerty, as follows:
- (a) the "common interest" category which justified certain persons with a legitimate common interest in the outcome of litigation in funding it;
  - (b) cases involving access to justice considerations; and
  - (c) a miscellaneous category of practices accepted as lawful which include sale and assignment by a trustee in bankruptcy and the doctrine of subrogation as applied to contracts of insurance.
62. In examining the public policy considerations that result in a contract being vitiated on the grounds of maintenance and champerty, the Court identified 4 points:
- (a) "In the first place, the traditional legal policies underlying maintenance and champerty continue to apply although they must substantially be qualified by other considerations. Thus the mischief to be discouraged by the law of maintenance is still "officious intermeddling in litigation" in particular where this results in oppression of the person against whom the action is brought and possibly if it may result in the general encouragement of litigiousness".
  - (b) "Secondly the fact that an arrangement may be caught by the broad definition of maintenance or champerty is not in itself sufficient to found liability. The totality of the facts must be examined asking whether they pose a genuine risk to the integrity of the Court's processes".

- (c) “Thirdly, countervailing public policies must be taken into account, especially policies in favour of ensuring access to justice and of recognising, where appropriate, legitimate common interests of a social or commercial character in a piece of litigation”.
- (d) “Fourthly, it is important not to confuse related but separate policies with those which properly underlie the operation of maintenance and champerty. For example, an agreement to take a share of litigation proceeds may be primarily objectionable because it involves the unconscionable exploitation of a vulnerable litigant. Or it may be considered objectionable for solicitors to enter into such an arrangement because it is thought likely to give rise to conflicts between the solicitor’s interest in financial gain and his duties to the Court and to the client. It may be right to strike down the arrangement in some cases. But in others, doing so (and characterising the conduct as criminal) in reliance on the law of maintenance and champerty may be to use too blunt an instrument. It may, for instance, result in the litigant being left with no means to pursue a good claim. Resort might more appropriately be had in such cases to other doctrines and remedies more suited to granting relief to the exploited party or to confronting professional misconduct”.
63. The Court emphasised that public policy is apt to change and in this context commented that “The continued retention by Hong Kong of criminal and tortious liability for maintenance and champerty may not be justified and this question merits serious legislative attention”. [119]
64. The Court held that the funding agreement which provided for the plaintiff to receive 10% of any compensation in excess of \$10m in arbitration proceedings was not champertous because:
- (a) the plaintiff had a genuine pre-existing commercial interest in the outcome of the arbitration; and
  - (b) Hong Kong Courts should not find an agreement void on maintenance and champerty grounds where it would not be so affected in the jurisdiction where it was to be performed (in this case, the Netherlands).

### **The position of Insolvency Practitioners**

65. As the Hong Kong Court of Final Appeal in *Unruh* noted, historically, the assignment of causes of action by liquidators and trustees in bankruptcy have been treated as an exception to the rules of maintenance and champerty and therefore valid.
66. The fruits of the action have also been treated as being assignable by a liquidator or trustee in bankruptcy in return for financing the action.

67. The justification for the exception (the “statutory power of sale exception”) is that under relevant legislation liquidators have a power to sell property of the company and “property” is defined broadly such that the Courts have held that it includes causes of action and the proceeds of those actions.
68. There is an assumption that Parliament having authorised the sale, cannot have intended to permit liquidators and trustees in bankruptcy to do something that was unlawful.

**Can the fruits of statutory causes of action be assigned?**

69. There is a difference in approach between the UK Courts and the Australian Courts to whether the fruits of statutory causes of action vested in the liquidator are assignable in return for funding. Such statutory causes of action include actions for trading whilst insolvent and to recover unfair or voidable preferences.
70. In both jurisdictions, the liquidator may validly assign the fruits of actions that were vested in the company prior to liquidation in return for funding for the litigation. There is no issue that this property is “property of the company”.
71. However, in the UK it has been held that the fruits of statutory causes of action are not property of the company capable of being assigned. Any funding agreement that purported to provide for funding in return for such an assignment would not fall within the statutory power of sale exception to maintenance and champerty.
72. The UK position is articulated in *Re Oasis Merchandising Services Limited* [1998] Ch 170 (“Oasis”) (and recently endorsed in *Ruttle Plant Limited v Secretary of State for Environment Food and Rural Affairs* [2008] EWHC 238). In that case the liquidator purported to assign the fruits of a statutory action for wrongful trading against 5 directors to a commercial funder in return for funding.
73. The Court of Appeal held that “the company’s property” in the relevant legislation does not include the fruits of litigation brought by the liquidator under section 214 (the wrongful trading provision). A distinction was drawn between assets which are property of the company at the time of the commencement of the liquidation and assets which arise after the commencement of the liquidation and which are only recoverable by the liquidator exercising his or her statutory power of sale. Only the former was held to be “property of the company” as that term is defined. The latter was property held on statutory trust for distribution.
74. Australian Courts have accepted that “property of the company” includes the fruits of statutory causes of action vested in the liquidator.

75. In *Re Movitor Pty Ltd v Sims* (1996) 14 ACLC 507 the liquidator sought directions from the Court as to whether he had the power to enter into a funding agreement to pursue a statutory insolvent trading action against former directors. He had no funds to pursue the case.
76. Drummond J held that the statutory authority to sell property of the company made lawful the “sale of a share in the proceeds of an action belonging to the company to a person with no interest in the litigation on the terms that that person is to have control of the litigation, although that would involve champerty but for the transaction being made under that authority”. [25]
77. Drummond J noted English authority to the effect that the statutory cause of action under s214 of the Insolvency Act 1986 (UK) was not an asset of the company, but distinguished it on the basis that the right to receive damages under the relevant Australian provision is for a “debt due to the company”. This debt was properly part of the property of the company.

**Can public policy be relied on to legitimise litigation funding for statutory causes of action vested in liquidators?**

78. In the Australian decision of *Re William Felton & Co Pty Ltd* (1998) 16 ACLC 1294, Justice Bryson determined that administrators of deeds of company arrangement could validly obtain litigation funding relying on the statutory power of sale exception. However, he said (at pg 1302):

“It might be thought that in a reasonable appraisal of what public policy now requires the law should allow litigation in insolvency situations to be financed by outsiders in return for a share in the proceeds”.

79. The usual circumstances in which liquidators seek litigation funding satisfy the strong public policy reasons that have been expressed by the courts in different jurisdictions (as referred to above) in favour of finding that funding arrangements are not champertous; namely
- (a) liquidators normally lack funds to pursue causes of action. Enabling statutory causes of action to be funded satisfies access to justice concerns referred to in *Fostif*, in *Unruh* and in *Arkin*; and
  - (b) there is a public interest in liquidators being able to pursue worthy causes of action. In Australia this has been a factor in the Courts approving litigation funding agreements with liquidators, including to pursue insolvent trading actions, see (for example *Hall v Poolman* [2009] NSWCA 64 (31 March 2009)).

80. Accordingly, there seems to be no logical reason, in view of recent decisions on maintenance and champerty, why the validity of a funding agreement with a liquidator should be judged solely

by reference to the statutory power of sale exception to maintenance and champerty and why it should not also be judged by reference to access to justice considerations.

81. In this modern light retaining the distinction made by the court in *Oasis* between pre liquidation property and post liquidation property is difficult to justify.

#### **The extent of permitted control by the funder**

82. There appears to be a difference between Australian Courts and English Courts in the acceptable degree of control a funder can exercise over litigation by a liquidator.
83. In *Oasis* the funding agreement required the conduct of the proceedings and any settlement negotiations to be in accordance with the directions of the funder.
84. The Court of Appeal held that the question of control related to the “propriety of the liquidator’s action in entering into the agreement and the correctness of the Companies Court in authorising this act”. The Court went on to say that “As a matter of policy we think that there is much to be said for allowing a liquidator to sell the fruits of an action for the reasons given by Drummond J [in the Australian decision of *Re Movitor Pty Ltd v Sims*], *provided that it does not give the purchaser the right to influence the course of or to interfere with the liquidator’s conduct of the proceedings*. The liquidator as an officer of the Court exercising a statutory power in pursuing proceedings must be free to behave accordingly”. (my emphasis)
85. The funding agreement considered in *Re Movitor Pty Ltd* provided for less control than an absolute right to direct (as in *Oasis*) but nevertheless it was not insubstantial. The funding agreement included these terms, which the Court found acceptable:
- (a) the solicitor was appointed jointly as solicitor for the liquidator and the funder;
  - (b) the liquidator was responsible for giving instructions to the solicitor. The liquidator was to keep the funder apprised of the progress of the proceeding and was to ensure the solicitor notified the funder immediately he became aware of any matter that would or may affect the premium set when assessing the insurance, or affect the decision whether to terminate, or lead to the settlement of the proceeding;
  - (c) the funder would instruct the solicitor to attempt to reach a settlement of the claim provided the company is in a no worse position than it would have been in had the proceeding been ultimately successful; and
  - (d) if any dispute arose between the liquidator and the funder as to instructions which should be given to the solicitor in relation to the settlement or conduct of a proceeding

the parties may refer the matter in dispute for advice from an independent third party to be mutually agreed, failing which the matter in dispute should be referred to an Arbitrator to be nominated by the President for the time being of the Law Institute of Victoria.

86. If one accepts the position of the Australian High Court in *Fostif* that control per se by a funder does not amount to an abuse of process, then the question of control in the context of insolvency funded litigation raises an issue separate from maintenance to champerty. The real issue is to what extent, if at all, the liquidator can assign discretionary powers vested in him or her by statute.
87. In Australia, the Courts have accepted a level of control by a funder in an insolvency context, which permits:
- (a) assistance by the funder in determining strategy and assistance in instructing the lawyers;
  - (b) a right to receive information and be kept informed of the progress of the litigation and of any settlement discussions;
  - (c) a right to have a say in any settlement and in the case of a disagreement with the liquidator, to have the matter referred to mediation; and
  - (d) a right to terminate the funding agreement without cause.
88. In *Elfic Ltd & Ors v Macks & Ors* [2001] QCA 219 (6 June 2001) the agreement required the liquidator to obtain the funder's approval before applying for a trial date, briefing counsel on trial, settling or discontinuing the claim and appealing against a final judgement. If the funder failed to give approval within a reasonable time the liquidator could refer the matter to senior counsel whose advice would be binding on both parties.
89. The Court concluded that as ultimate control of the litigation remained with the liquidator (including the right to apply to the Court for directions at any time) the agreement was not an abuse of process or against public policy (it should be noted that the High Court of New Zealand in *AMP Capital Investments No.4 Limited v IBS Group Limited (in liquidation)* [2008] NZHC 1740 (12 November 2008) refused to follow the Australian authority of *Elfic v Macks*, finding too much control lay with the funder of the liquidator in that case).
90. There is an implicit recognition by Australian Courts that if access to justice is a public policy to be promoted by enabling litigation to be funded by third parties for profit then a degree of commercialism and pragmatism is required in determining the permissible limits of that funding.

It is realistic to assume that a funder risking its funds in the conduct of the litigation will want to have some say in how that money is spent, in whether the case is settled and whether it continues to fund the case. Further, it cannot be in the public interest to deprive a funder of the right to terminate the funding agreement where, for example, to do so would force a funder to fund litigation that has low prospects of success.

### **Entering into funding agreement must be a bona fide exercise of power**

91. In Australia, a liquidator is normally not required to seek directions from the Court as to whether he or she is justified in entering into a litigation funding agreement (*Hall v Poolman* [2009] NSWCA 64 (31 March 2009)).
92. However, where an agreement is to last for more than 3 months (as most litigation funding agreements will do) the liquidator is required, by virtue of the Corporations Act, to seek approval to entering into the agreement from the creditors, the committee of inspection or the Court.
93. The entry into a funding agreement by an Insolvency Practitioner must be a bona fide exercise of the statutory power to dispose of property and must be done for proper purposes.
94. The Federal Court in *Addstone Pty Ltd (in liquidation)* (1998) 16 ACLC 1320 at 1330 identified the following non-exclusive list of considerations relevant to determining whether the disposal is bona fide:
  - (a) the nature and complexity of the cause of action;
  - (b) the amount of costs likely to be incurred in the conduct of the action and the extent to which the funding entity is to contribute to those costs;
  - (c) the extent to which the funding entity is to contribute towards the costs of the defendant in the event that the action is not successful or towards any security for costs by the Court before which the action is to be heard;
  - (d) the extent to which the liquidator has canvassed other funding options;
  - (e) the level of the premium (or percentage of the recoveries);
  - (f) the risks involved in the claim; and
  - (g) the liquidator's consultations with the creditors of the company.

95. Nevertheless, the Court observed that it is not for it to simply “substitute its own view on such matters for those of the liquidator and the advisor to the liquidator”.
96. The Courts give practitioners considerable latitude in exercising their own commercial judgment. In the context of a liquidation Giles J in *Re Spedley Securities* (1992) 9 ACSR 83 at 85 noted that:
- “the Court is necessarily confined in attempting to second guess the liquidator in the exercise of his powers, and generally will not interfere unless there can be seen to be some lack of good faith, some error of law or principle, or real and substantial grounds for doubting the prudence of the liquidator’s conduct”.
97. Accordingly, weight will be given to the liquidator’s expressed view that he or she considers the funding agreement to be reasonable and in the best interests of creditors.

#### **The size of the return to the funder**

98. Justice Drummond in *Re Movitor Pty Ltd* (referred to above) noted that if the funder was to “make a grossly excessive profit at the expense of the company” this might not be a bona fide exercise of the liquidator’s power.
99. However a high return may be justifiable in certain cases. In *Buiscex Ltd & Anor v Panfida Foods Ltd (In Liquidation)* [1998] NSWSC 516 the Court held that a return of 75% of the recoveries was not unreasonable in light of the fact that:
- (a) the chances of substantial recovery were not very high;
  - (b) there was no risk of loss to the creditors or the shareholders if the litigation was pursued; and
  - (c) the liquidator indicated that he had negotiated and that he believed the deal was reasonable.
100. In that case, there was opposition by the creditors to the funding agreement. Nevertheless, the Court gave its approval because there was no evidence that there was any significant chance that a better deal could be done or that the creditors’ opposition was based on a judgment by them that a better deal could be done.
101. The Judge was of the view that the wishes of the creditors did not outweigh the interests of the minority shareholders who might benefit from the investigations and litigation, or the judgment of

the liquidator. Further, the Judge noted that it was in the public interest for possible breaches of duty involving losses of the magnitude involved to be investigated.

102. In both *Re Addstone Pty Ltd (in liquidation)* (referred to above) and *Re ACN 076 673 875 Ltd* [2002] NSWSC 578 (26 June 2002) the maximum percentage of the recoveries that the funder was entitled to receive was 40% and in both cases the Court approved the funding agreement.

#### **Access to the Funding Agreement and to Legal advice of the Liquidator by the Defendant**

103. Unless there is a specific issue before the Court concerning the funding of the case, the funding agreement will not be relevant to a matter in issue in the proceedings and so will not normally be required to be produced to the defendant.

104. Examples of circumstances where the funding agreement may be relevant to an issue include where:

- (a) the liquidator seeks Court approval to enter into a funding agreement or Court directions that he or she is justified in doing so; or
- (b) (normally outside a liquidation context) the defendant has alleged that the proceedings should be stayed because there is an abuse of process because they are being funded (in Australia, in light of *Fostif* an application for a stay based purely on the existence of funding will be very unlikely and the position is likely to be the same in Hong Kong (see *Unruh*)).

105. In *Re Kingsheath Club of the Clubs Ltd (In Liq)* [2003] FCA 1034 (30 September 2003) the liquidator had sought Court approval to enter into a litigation funding agreement and had filed an affidavit in support of that application. The liquidator had exhibited the funding agreement to his affidavit as a confidential exhibit and had referred, in the affidavit, to legal advice he had received in these terms:

“I have received legal advice....I am of the opinion on the basis of the legal advice that I have received in this regard that Kingsheath has very good prospects of success in prosecuting the Cause of Action....I have further received legal advice from my solicitors that I have a strong claim under section 588G....and that such application has good prospects of success”.

106. Some of the creditors (who were also proposed defendants), applied to the Court for access to the funding agreement in order to determine whether they should oppose the liquidator's application for Court approval and sought access to the legal advice referred to in the liquidator's affidavit.

*As to the Applicants' right to be heard*

107. Goldberg J held that, notwithstanding the fact that the applicants were potential defendants (and so might benefit if the funding agreement was not approved), it was appropriate for the applicants to be heard on the liquidator's application as creditors. He said "As creditors they have an interest in how the liquidator deploys the funds of Kingsheath at his disposal. They have also been served with the application" [22].

*As to access to the funding agreement*

108. Goldberg J ordered that the applicants have access to the funding agreement but that the amount of the funding proposed or agreed to and the return to the funders set out in the funding agreement be blanked out.

109. He held that...."it would give them [the applicants] an unfair advantage in any litigation brought by the liquidator against them for them to have knowledge of the amount of money available to the liquidator to run the litigation....There is a real risk that disclosure of the amount of funding available to the liquidator to proposed defendants in proposed litigation would frustrate or impede the purpose of the liquidator's application for the court's approval to enter into a funding agreement. It may enable the proposed defendant to assess and implement the extent to which they could, by way of interlocutory processes, eat up the liquidator's funding before the conclusion of the trial" [33], [34].

*As to access to the legal advice referred to in the liquidator's affidavit*

110. Goldberg J held that the liquidator had waived legal professional privilege in the advice which initially protected it from disclosure by relying on it in the manner he did. He had not simply referred to the fact or existence of the advice, he had relied on it "to support and provide the basis for his opinion that he has "very good prospects of success" and a "strong claim" in respect of his causes of action" [42].

111. However, as a matter of discretion, Goldberg J declined to order production of the advice as it was "not normally material which is available to an opposing party in litigation and disclosure of it may have a tendency to frustrate the purpose for which the application by the liquidator for approval to enter into the Funding Agreement has been made" [43].

**Legal professional privilege – an alternative ground to resist production**

112. In *Re Kingsheath Club of the Clubs Ltd (in liq)*, Goldberg J noted that the liquidator had not sought to claim legal professional privilege in respect of the funding agreement.

113. Some Australian cases have held that the funding agreement is subject to legal privilege and therefore exempt from production (see *Re Global Medical Imaging Ltd* [2001] NSWSC 476, *Apple v Wily* [2002] NSWSC 855, *Martin John Green in his capacity as liquidator of Arimco Mining Pty Ltd (in liquidation) v CGU Insurance Limited & Ors* [2008] NSWSC 390). These cases turn on the application of specific legislation concerning rules of evidence.
114. In *Martin John Green in his capacity as liquidator of Arimco Mining Pty Ltd (in liquidation) v CGU Insurance Limited & Ors* [2008] NSWSC 390 Einstein J considered whether confidential portions of a litigation funding agreement were privileged from production under section 119 of the Evidence Act 1995 (NSW). Those portions included the maximum amount the funder would provide for the liquidator's own professional costs and for the legal costs of the proceedings.
115. Einstein J held that the funding agreement was prepared for the purpose of the liquidator being provided with funding but that purpose itself was "inextricably linked with the purpose of the [the liquidator] being provided with professional legal services". Accordingly, section 119 of the Evidence Act applied and production was not required.
116. In *Spatialinfo Pty Ltd v Telstra Corporation Limited* [2005] FCA 455 Sundberg J reached a different conclusion based on the application of the common law test for privilege, finding that the funding agreement would not pass the test of being created for the dominant purpose of being used in existing or anticipated litigation.
117. The issue of whether legal professional privilege attaches to a funding agreement has been raised in Hong Kong, although as far as the writer is aware, not determined.
118. In litigation by *Akai Holdings Ltd (in compulsory liquidation)*, by summons dated 22 December 2008, certain defendants sought orders for security for costs and an order that the litigation funding agreement in that case be produced.
119. The production order for the litigation funding agreement was not pursued (presumably because the security for costs application was dealt with by a consent summons).
120. Nevertheless, it is clear from the judgment of Stone J in *Akai Holdings Limited (in compulsory liquidation) and others v Ho Wing On and others* delivered on 9 February 2009, that the liquidator claimed that the funding arrangements were strictly confidential and subject to legal professional privilege (see para 133). As the summons for production was not pressed, Stone J did not consider the claim for legal professional privilege.

## Oppression as a ground to resist production of documents

121. Defendants may seek production of documents beyond the funding agreement, including those the funder has relied on in coming to its decision to fund the case.

122. In *Spatialinfo Pty Ltd v Telstra Corporation Limited* [2005] FCA 455 (a case not concerning a company in liquidation) an application was made to set aside subpoenas served on the plaintiff and funder. Telstra had served the subpoenas in aid of its motion seeking, among other things, an order that the proceedings be stayed based on maintenance and champerty.

123. The subpoena sought production of documents from the funder (IMF), including:

- (a) documents requested by the funder from the applicant following the applicant's lodgement of the proposal form for funding and which the funder referred to or considered in connection with the decision to provide funding; and
- (b) all written correspondence (including emails) between the funder and the applicant or its solicitors of record in the proceeding relating to the proceeding or the funding (or continued funding) thereof.

124. Sundberg J held [at 52] that:

“The evidence summarised at [48] to [50] discloses, and I find, that production of the documents sought by the subpoenas:

- will involve a breach by IMF of its obligations under the confidentiality agreement
- will result in the disclosure to Telstra of the funders' own confidential documents
- will provide Telstra with a significant forensic advantage in the proceeding, unrelated to Telstra's motion, which will increase the risk that Spatialinfo will be unsuccessful in its proceeding, to the funders' detriment
- is likely to discourage Spatialinfo from disclosing further confidential information to the funders, thus increasing their risk in funding the proceeding
- will result in the curtailment of the funders' funding of new matters, because potential seekers of funding will not wish to disclose confidential information if the funders are obliged to produce it to their opponents in the litigation
- is likely to result in those who do in the future seek funding not being prepared to provide the full and frank disclosure that is vital to the funders' assessment of the risks of funding the litigation”.

125. On this basis Sundberg J concluded that “the subpoenas are seriously and unfairly burdensome, prejudicial or damaging” to the funders, and are thus “oppressive”. The fact that the subpoenas

were “fishing” for evidence was also a factor that compounded this oppression. Accordingly, the subpoenas were set aside.

### **Relevance of litigation funding to security for costs orders**

126. The New South Wales Court of Appeal has held that where there is a funder who stands to benefit from the proceedings and is not interested in having rights vindicated (such as a creditor or shareholder), but whose interest is in making a profit from the litigation, the Court should be readier to order security for costs; including where the plaintiff is the liquidator personally as opposed to the company (*Green (as liquidator of Arimco Mining Pty Ltd) v CGU Insurance Ltd* [2008] NSWCA 148 (20 June 2008)).
127. Hodgson JA expressed the rationale as being that “although litigation funding is not against public policy...the Court system is primarily there to enable rights to be vindicated rather than commercial profits to be made; and in my opinion Courts should be particularly concerned that persons whose involvement in litigation is purely for commercial profit should not avoid responsibility for costs if the litigation fails.” [51]
128. In this case the potential return to the funder set out in the funding agreement was the subject of a successful claim to legal professional privilege (as referred to above). Hodgson JA said that “It may be that where the Court knows the extent of the funder’s interest in the outcome of the case, this could be a factor which might lead the Court to order security for less than the totality of the costs” [53].
129. The existence of litigation funding was also treated as being relevant in a security for costs application decided by the Court of Appeal of Hong Kong on 2 April 2009 in *Akai Holdings Limited (in compulsory liquidation) v Thankharn Kasihorm Thai Chamhat (Mahachon)*.
130. The only issue was the amount of security, as it was accepted that security should be given. The defendant bank sought \$6.48m and the liquidator had offered \$2.4m. Le Pichon JA said:
- “In this case the appellant being a company in liquidation is being funded by funders whose identities are not known and are believed to be out of the jurisdiction. Although there would not appear to be any impediment to pursuing the funders for any shortfall in the event of the bank successfully resisting the appeal and obtaining taxed costs that exceed the amount of security granted, it will have, first of all, to take steps or even issue proceedings in order to find out who the funders are and then decide whether or not to pursue them. I think this is an unusual circumstance that I ought to take into account”.
131. It is not clear from the decision exactly how the fact of funding was taken into account in the Judge’s decision that the amount of security ordered should be HK \$3 million.

## Relevance to a Mareva Injunction

132. In *Akai Holdings Limited (in compulsory liquidation) and others v Ho Wing On and others*, in the Court of First Instance of Hong Kong, decided on 9 February 2009, Stone J considered the fact that the litigation was funded to be relevant to the application by Akai for a Mareva Injunction.
133. Counsel for the defendants submitted that the funding of the action brought with it “wholly legitimate concerns as to the risk of wildly inflated claims and unreliable evidence, and that this remained the situation even if (as he now accepted) the funding in question did not amount to champerty of a kind or degree which otherwise would justify a stay of those proceedings”. [135]
134. Justice Stone confessed that he found “this ‘third party venture capital approach’ to litigation wholly unappealing”. [129] He said that:
- “I have no compunction in stating that the ‘funding issue’ has been in the forefront of my mind *first*, in the exercise of my discretion in terms of the ‘balance of convenience’ with regard to the relief sought as against Grande, and *second*, (and as will shortly become apparent), in deciding upon the monetary level at which to pitch the specific *Mareva* injunctive relief which I have decided to grant directly against the 1<sup>st</sup> defendant herein, Mr Ho.” [142]
135. It is not clear exactly how Stone J took into account the “funding issue”, however he did decide that the appropriate sum for which to grant Mareva relief was US\$200 million, well below the US\$500 million sought by the plaintiffs.
136. He concluded by saying that he did not accept the assertion that the application: “is in substance no more than a “tactical ploy” instigated by an unidentified third party funder (or funders) in a bid to exert commercial pressure and to “fish” for documents to which the plaintiffs plainly are not entitled; whilst I can appreciate the temptation to express the position thus in the circumstances, I consider that this is to pitch the case too high”. [190b.]
137. The impression one gets reading the judgment is that the Judge’s concerns were heightened by the following:
- (a) the plaintiffs had not made the litigation funding arrangement available to his Court or to the Defendants (although prior Court approval to it had been obtained);
  - (b) the funder was not identified; and
  - (c) the funder was out of the jurisdiction.

138. Nevertheless, if any attention was to be paid to the submissions of the defendant that the existence of litigation funding per se (absent any evidence) raised concerns about the risk of inflated claims and unreliable evidence, this would be, with respect, a retrograde step, and not in keeping with the modern judicial attitude to litigation funding as evidenced by the various cases referred to in this paper.
139. Further, if the above submission were accepted, it would arguably reflect a surprising lack of confidence on the part of the Court in the solicitors charged with the carriage of the matter for the plaintiff who, it should be assumed, would conduct the case in accordance with their duties to the Court and client.
140. In Australia, a conscious decision was taken by IMF (Australia) Ltd to operate its funding business in a public listed entity, in part, in the interests of transparency. Subject to the possible need to redact parts of the funding agreement which discloses the amount of funding made available, when funding liquidators IMF has taken the approach of disclosing its funding agreement to the defendant and the Court and of submitting itself to the Court's jurisdiction.
141. In any cases it funded in Hong Kong, IMF would do the same.
142. Civil Justice Reform, which came into effect in Hong Kong on 2 April 2009, enables the Hong Kong Courts to make costs orders against a non party if it is in the interest of justice to do so. Such non parties would include litigation funders.

## **Conclusion**

143. Concerns about the potential impact of litigation funding on the integrity of the judicial system have significantly diminished with a recognition and acceptance that current systems of civil justice are robust and strong.
144. These concerns have receded and been replaced with a growing public concern about the increasing costs of litigation and an emphasis on the public policy in favour of access to justice. This has driven a growing acceptance of litigation funding in common law jurisdictions around the world.
145. It is appropriate that litigation funding first took root in causes of action to be pursued by insolvent entities and those appointed to administer them. Insolvent entities fit squarely within the public policy objectives promoted by funding, generally lacking the funds to pursue litigation and in many cases pursuing litigation for a broader public interest.

146. Accordingly, it is appropriate that the justification for litigation funding for insolvent entities not be fixed in time by reference to a statutory power of sale exception but that access to justice considerations be the predominant consideration. Once seen in this light it is difficult to justify an approach that prevents liquidators from legitimately receiving funding for the pursuit of statutory causes of action that vest in them.

147. The modern trend is clearly in favour of litigation funding. In the words of the Full Court of the Federal Court of Australia in *Gore v Justice Corporation Pty Ltd* [2002] FCA 354:

“There are ongoing concerns about the high costs of litigation; there are risks that citizens with justifiable causes of action may be kept out of Courts because of their inability to pay the costs of litigation or because they fear the financial risks of litigation. If, in such circumstances, a business house, openly and reasonably, wishes to engage in the business of funding litigation and is prepared to meet the costs of the opposing party should that party be successful, we see no cause for instant alarm”.

Clive Bowman

25 September 2009